Supreme Court, U.S.
FILED
081546 JUN 16 2009
OFFICE OF THE CLERK

No.

In the

Supreme Court of the United States

KENNETH C. KEENER,
WILLIAM P. SMITH, and ANNE D. SMITH,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON A PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether 26 U.S.C. §7422(h) denies the United States Court of Federal Claims subject matter jurisdiction over partner-level suits for refund of interest assessed at the enhanced rate under former 26 U.S.C. §6621(c)?

2. Is a partner's assessment deadline for taxes arising from his partnership items a §6231(a)(3) partnership item?

3. If so, does §7422(h) deny the Court of Federal Claims subject matter jurisdiction to hear the partners' refund suit based on an assessment made after that deadline expired?

PARTIES TO THE PROCEEDINGS BELOW

The following were the parties to the proceedings below before the United States Court of Federal Claims and the Court of Appeals for the Federal Circuit:

Kenneth C. Keener,

William P. Smith,

Anne D. Smith, and,

The United States of America.

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OPINIONS BELOW

The opinion below of the United States Court of Appeals for the Federal Circuit is reported at *Keener v. U.S.*, 551 F.3d 1358 (Fed.Cir. 2009) ("*Keener*"). App. 1-17.[1] The opinion of the United States Court of Federal Claims is reported at *Keener v. U.S.*, 76 Fed. Cl. 455 (2007). App. 18-51.

The conflicting opinions are: from the Court of Appeals for the Fifth Circuit are reported at *Weiner v. U.S.*, 389 F.3d 152 (5th Cir. 2004); the Second Circuit at *Field v. U.S.*, 328 F.3d 58 (2nd Cir. 2003); the Sixth Circuit at *Barlow v. C.I.R.*, 301 F.3d 714 (6th Cir. 2002); and the Ninth Circuit at *Keller v. U.S.*, — F.3d — , 2009 WL 1532197 (June 3, 2009). App. 124-143, 52-56, 144-162, and 63-90, respectively.

Related opinions are reported at *Irom v. C.I.R.*, 866 F.2d 545 (2nd Cir. 1988); *Prochorenko v. U.S.*, 243 F.3d 1359 (Fed.Cir. 2001); *River City Ranches v. C.I.R.*, 401 F.3d 1136 (9th Cir. 2005). App. 57-62, 91-106, and 107-123, respectively.

JURISDICTION

The judgment of the Federal Circuit was filed on January 8, 2009. Rehearing *en banc* was denied March 18, 2009. App. 163-164. This Court has jurisdiction under 28 U.S.C. §1254(1).

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

The relevant constitutional provisions, statutes, and regulations are set forth in the appendix to this petition.

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[1] References to "App. x" are to page "x" of the attached Appendix.

App. 64-183.

STATEMENT OF THE CASE

This case concerns jurisdiction of the United States Court of Federal Claims and the federal district courts to address two issues common to TEFRA[2] partnership related tax disputes: (i) imposition of the former 26 U.S.C. §6621(c)[3] "penalty" rate of interest,[4] and (ii) partners' claims for refund of taxes assessed after limitations expired.

In the early 1980s AMCOR, a corporation, was managing agent for many limited partnerships. The partnerships would contract with farmers to grow crops on the farmers' land in the first year, sell those crops, buy land to grow crops in later years and, eventually, sell the land at a profit.

The partnerships relevant here filed 1984-1986 Forms 1065 partnership tax returns reporting deductions on Schedule Schedule F - Farming Expenses and Other Deductions. Keener and the Smiths timely filed their 1984-1985 tax returns and reported the farming expenses allocated to them by their partnerships, as required by §6222(a). App. 3.

In 1990 and 1991, the IRS issued Notices of Final

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[2] Partnership procedures codified at 26 U.S.C. §§6221-6233, as enacted by the Tax Equity and Fiscal Responsibility Act of 1982, Pub.L. No. 97-248, 96 Stat. 324 ("TEFRA"). Effective for tax years after September 3, 1982; see generally *Maxwell v. C.I.R.*, 87 T.C. 783, 787 (1986).

[3] Unless otherwise stated references to "Section," "sec.", "§" are to sections of the Internal Revenue Code at 26 U.S.C.

[4] Technically, §6621(c) is not a penalty though it is commonly referred to as "penalty interest."

Partnership Administrative Adjustment ("FPAAs") challenging deductions claimed by 43 of the AMCOR partnerships.[5] The FPAAs proposed to totally disallow all Schedule F farming expense deductions on multiple, independent, alternative, and in some cases mutually exclusive grounds, some of which were §6621(c) "tax motivated transactions" ("TMTs"), but many of which were not. App. 3, 220-255.

Partners challenged the FPAAs by filing §6226(b) partnership-level suits in the United States Tax Court. App. 3.

While those suits were pending, roughly half of the partners – including Weiner and the Kraemers (who live in the Fifth Circuit) and Keener and the Smiths (who do not) – settled their partnership items with the IRS on Forms 870-P(AD). The settlements allowed roughly 50% of the farming expenses. But the settlements did not (i) state any basis for the agreed disallowance of the other 50%, or (ii) waive the limitations period to assess. Nor did they mention §6621(c) penalty interest, "sham transaction," or any of the many other proposed grounds for disallowance shotgunned in the FPAAs. App. 3-4.

Settlement converts partnership items to non-partnership items and removes that partner from the court's jurisdiction in partnership-level suits. §§6226(d)(1)(A), 6231(b)(1)(C). App. 168, 173. Unsettled partners remained parties unless their assessment period had expired or they were otherwise barred. §§6226(c), (d)(1)(A) and (B). App. 167-8.

In 1998 and 2000, the IRS assessed tax and interest against Keener and the Smiths, respectively, based on their

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[5] There were roughly 2500 partners/partnership interests involved in the 43 affected partnerships.

settlements. Those assessments were paid in full. App. 4. The IRS imposed the "penalty" rate of interest.

In 2001, agreed decisions purportedly reflecting agreements between the IRS and the TMPs were entered in the suits allowing a different amount but, again, roughly 50% of the expenses. App. 4.

Hundreds of settled partners (including Weiner, the Kraemers, Keener, and the Smiths) and unsettled partners filed substantively similar refund claims with the IRS to recover all or part of what they had paid based on three common grounds, that: (i) the penalty rate was improper as a matter of law because it was imposed in contravention of §6621(c) and Treas. Reg. §301.6621-2T, A-5, (ii) 1984 and 1985 liabilities were assessed after limitations expired, and (iii) interest from 1989-1993 should be abated under §6404.[6] App. 5.

The IRS denied their refund claims. Weiner and the Kraemers filed suit in federal district court in Texas. Later, Keener and the Smiths filed suit in the Court of Federal Claims pursuant to 28 U.S.C. §§1346(a)(1) and §1491(a)(1). App. 4.

Over 200 such suits have been filed, roughly equally split between the district courts of the Fifth Circuit and the Court of Federal Claims.

Weiner was chosen as the test case for the Fifth Circuit suits and consolidated for appeal with *Kraemer*.[7] The Fifth

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[6] *Hinck v. U.S.*, 550 U.S. 501 (2007) held that the Tax Court has exclusive jurisdiction over §6404 claims. The §6404 claims are no longer at issue.

[7] *Kraemer v. U.S.*, 2002 WL 575791 (S.D. Tex. 2002)(unpublished). The Government asserts *Weiner* does not control unsettled partner cases because that liability arises from the Tax Court agreed decisions, not

Circuit held that §6621(c) penalty interest was improperly imposed as a matter of law and must be refunded, but dismissed the limitations claims for lack of subject matter jurisdiction pursuant to §7422(h), which bars partner-level refund suits attributable to partnership items. App. 125, 143.

Prati was chosen as the test case for the suits in the Court of Federal Claims. *Prati v. U.S.*, 81 Fed.Cl. 422 (2008), on appeal to the Federal Circuit at No. 08-5117. The majority of these cases were transferred to Judge Block and stayed pending the outcome of *Prati*. All Court of Federal Claims judges who retained their AMCOR refund cases agreed to stay the proceedings pending the outcome of *Prati*, with the exception of Judge Allegra who retained and consolidated *Keener* and *Smith*, which were decided on cross-dispositive motions.

In 2007, after briefing on cross- dispositive motions in *Prati*, but before Judge Block issued his opinion, Judge Allegra issued the Court of Federal Claims decision in *Keener*, dismissing all claims for lack of jurisdiction pursuant to §7422(h). App. 18-51. The appeal in *Keener* was the first AMCOR suit, after *Hinck*, to reach the Federal Circuit.

While *Keener* was on appeal, Judge Block issued *Prati*, the actual AMCOR test case, holding that §7422(h) bars jurisdiction over both §6621(c) and limitations, but on different grounds and analyses than the *Keener* trial court as to both issues. *Prati* at 440.

Despite having stayed the other AMCOR cases pending final appellate outcome of *Prati*, Judge Block summarily entered judgments in the other 77 related cases before him,

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from the settlements. *See Duffie v. U.S.*, 2008 WL 4525370 (S.D.Tex. 2008)(unpublished), on appeal to the Fifth Circuit at No. 08-20708.

15 of which were subsequently vacated and the cases re-stayed. *Prati*, at 425, 440. Judge Block refused to vacate judgments in and re-stay the other cases. Not all partners elected to appeal.[8] Consequently, 55 appeals were filed. The Federal Circuit stayed all 55 appeals. Only *Prati* has a record sufficient to support appeal on the merits.[9]

No other Court of Federal Claims judge has issued judgments based on *Prati* or *Keener*.

In 2009, the Federal Circuit issued *Keener*, upholding the §7422(h) bar to jurisdiction for both §6621(c) and limitations, but on different grounds than the trial court or *Prati*. App. 16.

In *Prati*, the Federal Circuit is currently reviewing: (i) Government motions to summarily affirm based on *Keener*, and (ii) taxpayer motions to proceed in *Prati* and to continue stays in the other 54 appeals until the resolution of *Prati* and this petition for *certiorari*.

Weiner, the Kraemers, and many other Fifth Circuit partners received refunds of the §6621(c) penalty interest.[10] Agreed Final Judgments have been entered in 38 of the Fifth Circuit cases, 17 of which include either Keener or the

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[8] Some taxpayers were unable to pay the appellate filing fee and lost their claims.

[9] See the Appellants' Motion to Lift Stay and Proceed with this Appeal and Status Report on Related Appeals [Entry #12] in *Prati v. U.S.* (Fed.Cir. 08-5227).

[10] See satisfactions of judgment dated January 7, 2008, in *Weiner v. U.S.* (Document #124), and *Kraemer v. U.S.* (Document #82), both before the Southern District of Texas at Docket #00-1297 and #00-2948, respectively.

Smiths' partnerships.[11] App. 184-7.

REASONS TO GRANT THE PETITION

This case concerns whether §7422(h) bars subject matter jurisdiction in partner-level suits over claims for refund of (i) §6621(c) penalty interest resulting from partnership item adjustments, or (ii) tax and interest assessed and paid after the partner's assessment period expired.

Both issues merit review. Grounds for each are addressed separately.

1. Section 6621(c) Penalty Interest

Keener mischaracterized Keener and the Smiths' §6621(c) claims, creating a split with the Fifth Circuit's decision in *Weiner*, the Second Circuit's decision in *Field*, the Sixth Circuit's decision in *Barlow*, and the Ninth Circuit's decision in *Keller*. *Keener* also violates partner First and Fifth Amendment due process rights.

Weiner considered §7422(h), but not expressly as to §6621(c). *Weiner* recognized these claims are based on the IRS's failure to follow the controlling statute and regulation for imposing §6621(c), which is directly applicable because there are many separable, alternative grounds for adjusting the partnership farming expense. App. 137-9, 140-3. *Keener* is fundamentally flawed because it ignores the controlling statute and regulation and presumes the claims directly challenge the grounds for the adjustments set out in the FPAAs, which it assumed were inseparable. App. 13-16.

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[11] See the Joint Report of Related Cases (Document #131) dated April 17, 2009, in *Weiner v. U.S.*, at Docket #00-1297 in the Southern District of Texas.

Keener also splits with *Field*, which held §7422(h) is narrowly read and does not bar §6621(c) claims. App. 53-55. On this issue, *Keener* also splits intra-circuit with *Prorochenko*, in which the Federal Circuit previously followed the Second Circuit and adopted a narrow reading of §7422(h) for similar claims. App. 96-97. *En banc* reconsideration of *Keener* was denied despite this intra-circuit conflict. App. 163-64.

Keener erroneously relied *River City*, a Ninth Circuit decision respecting the large group of "Hoyt Partnership" §6621(c) cases. App. 107-123. The *Keener* trial court determined there was a split with respect to §6621(c) claim jurisdiction. App. 45-46. The Federal Circuit relied on *River City* for its §6621(c) determination. App. 11, 13-14.

But in *Keller* the Ninth Circuit itself distinguished *River City*, holding that the Tax Court, in a subsequent partner-level proceeding, may and should address whether §6621(c) can be applied where no express §6621(c) determination was made at the partnership level. App. 84-85. *Keller* noted that such a failure leaves taxpayers with no possible review of imposed penalty interest. App. 84-85.

Barlow held that the lack of a *pre*-payment forum to challenge §6621(c) penalty interest does not violate taxpayer Fifth Amendment due process rights because taxpayers have a *post*-payment, refund forum. App. 157. At least for pre-1997 tax years, jurisdiction in partnership-level §6226 proceedings is statutorily limited to partnership items.[12] Where, as here, the IRS imposes §6621(c) after partnership-level proceedings have concluded without establishing the prerequisite grounds to impose it, under

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[12] Section 6226 was amended in 1997 to include penalties and additions to tax. H.R.Rep.No. 105-148 at 593-4. The changes are effective for tax years after August 5, 1997, they do not apply here, and this petition does not address them.

Keener the partner-level refund suits are barred, leaving taxpayers with no forum to challenge that improper assessment.

a. Overview of Controlling Law

Section 6621(c) imposes interest at 120% of the standard rate on underpayments over $1,000.00 "attributable to" one of the TMTs defined in §6621(c) and Treas. Reg. §301.6621-2T, A-5. App. 175-6, 180-82. That regulation mandates the use of a formula to calculate what portion of any underpayment is "attributable to" a TMT. Section 6621(c) was repealed five years after enactment, but applies for the tax years at issue. See the discussion in *Copeland v. C.I.R.*, 290 F.3d 326, 330-32 (5th Cir. 2002).

Under §7422(h), "[n]o action may be brought for a refund attributable to partnership items ...." App. 177. This bar turns on the "attributable to" requirement and TEFRA's §6231(a)(3) definition of "partnership items" as:

> any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of [subtitle F], such item is more appropriately determined at the partnership level than at the partner level.

App. 173.

Treas. Reg. §301.6231(a)(3)-1(b) identifies as partnership items "the legal and factual determinations that underlie the amount, timing, and characterization of income, credit, gain, loss, deduction, etc." App. 183.

Two other types of "items" are defined in TEFRA. A "non-partnership items" is one "which is (or is treated as) not a partnership item." §6231(a)(4). "Affected items" are any items "to the extent they are affected by a partnership item." §6231(a)(5). App. 173.

Section 7422(h) applies only to "a refund attributable to a partnership item," without mentioning affected items. App. 177. These claims "concern" partnership items, but only in that by definition ***all*** affected items "concern" partnership items. Congress made important distinctions in the assessment and refund procedures related to partnership items and affected items. Where Congress meant both it said both.[13]

Field recognized 20 years of precedent holding §6621(c) penalty interest is an affected item and held claims that challenge its improper imposition are not barred by §7422(h). App. 52-55.

i. Section 6621(c) Was Intended to Encourage Settlement

Congress enacted §6621(c) and other accuracy related penalties (*e.g.* §6659) to encourage settlements and lighten the Tax Court's docket.[14] In reliance on this legislative intent, the Tax Court and Fifth Circuit have consistently refused to re-open cases for the sole purpose of establishing a basis to impose these penalties and penalty interest.[15]

In repealing §6621(c), Congress noted it and other accuracy-related penalties were "too routinely and

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[13] *E.g.*, §6230(d)(6) was amended in 1997 to refer *only* to refunds "attributable to a partnership item. When §6230(d)(6) was amended, §§6230(d)(1)-(5), each referring to both, were unchanged. Similarly, §6230(a)(2) establishes different rules for assessing a tax deficiency "attributable to ... affected items ..." from the rules under §6230(a)(1) for assessing deficiencies directly resulting from a change "which properly reflects the treatment ... of a partnership items."

[14] See the discussion of legislative history in *Todd v. C.I.R.*, 862 F.2d 540, 544 and n.14 (5th Cir. 1988) ("*Todd*") and *Todd v. C.I.R.*, 89 T.C. 912, 916-18 (1987).

[15] *See Todd*; *Law v. C.I.R.* , 84 T.C. 985 (1985); *Rogers v.* C.I.R., 60 T.C.M. (CCH) 1386 (1990); *Schachter v. C.I.R.*, 67 T.C.M. 3092 (1994).

automatically" imposed in contravention of the intent to encourage settlement.[16] As the Fifth Circuit noted in *Weiner*, "fifteen years after the statute's repeal, imposing the penalty in situations such as this does nothing to relieve the Tax Court's backlog, when the taxpayers have in fact settled with the IRS." App. 143.

Keener discourages settlement by forcing continued litigation solely to establish or disprove grounds to impose §6621(c), which violates Congressional intent and wastes administrative and judicial resources.

ii. <u>These Claims Are Not Barred By §7422(h) Because They Do Not Challenge the Underlying Partnership Item Adjustments</u>

The claims assert the IRS imposed §6621(c) even though the underpayments were not "attributable to" a TMT as required by statute and Treas. Reg. §301.6621-2T, A-5.

As a general rule, if the grounds for adjustment are not re-determined by settlement or a court of competent jurisdiction, then all grounds for adjustment in the FPAA are considered in making the §6621(c) "attributable to" determination.[17] App. 137, 143. The settlements here did

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[16] H.R.Rep. 101-247, 1989 WL 168143 (Leg.Hist.), **2863,*1393; 135 Cong.Rec. S13057-03, 1989 WL 195142 (Cong.Rec.) *S13175.

[17] See §§6225(a), §6226(a), (f), 6229(d), 6231(b)(1)(C). However, as here, often the shotgunned FPAA grounds are mutually contradictory or inconsistent with the settlements or decisions and logically cannot all be "conclusive." Here, allowance of over 50% of the deductions belies any assertion that the underpayments are attributable to "sham," which results in full disallowance of the deduction. *Rink v. C.I.R.*, 47 F.3d 168, 172 (6th Cir., 1995). It is improper to split the nature of a partnership item from the underlying adjustment and re-characterize it inconsistently. *Fickling v. U.S.*, 507 F.3d 1302, 1305 (11th Cir. 2007).

not include §6621(c) penalty interest as a settlement term or specify the grounds for the adjustments. The FPAAs proposed as many as 14 alternative, separable grounds for making an undifferentiated adjustment to the farming expenses, some of which are TMTs but the majority of which are not. App. 220-255.

Weiner correctly applied the regulation which mandates the manner for determining whether an underpayment is "attributable to" a TMT:

> (1) Calculate the underpayment using all proper adjustments.
>
> (2) Without taking into account adjustments attributable to TMTs, calculate the underpayment using only the adjustments attributable to non-TMTs.
>
> The difference between (1) and (2) is the amount of tax motivated underpayment.

App. 138-39.

Weiner recognized several consequences of the regulation. It is not proper to consider only the TMT grounds and ignore the non-TMT grounds for adjustment because the regulation mandates that the non-TMT grounds be considered first. Because non-TMT grounds are considered first, if the IRS shotguns the grounds for adjusting a single item, *i.e.*, asserts multiple, alternative grounds, some TMTs and some not, then there is no remaining portion of the underpayment solely "attributable to" the TMT grounds. App. 140-41, 143.

Application of this regulation is the heart of these claims and the Fifth Circuit's holding that §6621(c) was improperly imposed as a matter of law. That Court found that both the §162 and "not trade or business" non-TMT grounds for adjusting the expenses in the FPAAs were

separable and independent of any other TMT grounds for adjustment and established that the underpayment could never be solely "attributable to" sham as required by the regulation. App. 141. The Fifth Circuit held "[t]here is no way, given the multiple reasons provided for the disallowance in the FPAAs, to determine whether the underpayments are 'attributable to' a tax motivated transaction." App. 141.

These same independent grounds are in Keener and Smith's partnership FPAAs. A complete review of the FPAAs for the *Keener*, *Smith*, and *Weiner* partnerships makes clear that these same independent grounds are set forth in all of them. App. 220-255.

In *Todd*, the Fifth Circuit issued the earliest circuit court decision construing the "attributable to" requirement. The Second, Ninth, and Tenth Circuits have all accepted the Fifth Circuit's construction of that term. The Tax Court has consistently applied the regulation as construed by the Fifth Circuit.[18]

The IRS had expressly and publically acknowledged this construction and the consequences of the regulation at the time of settlement.[19]

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[18] *See McCrary v. C.I.R.*, 92 T.C. 827 (1989). *Irom*, App.60-1; *Todd, supra.*; *Gainer v. C.I.R.*, 893 F.2d 225,228 (9th Cir. 1990); *Scoville v. C.I.R.*, 108 F.3d 1386 (9th Cir. 1997), an unpublished opinion; and *Borgardus v. U.S.*, 956 F.2d 277 (10th Cir. 1992)(unpublished), *citing Todd* and *Gainer* and *affm'g Borgardus v. U.S.*, 91-1 USTC ¶50,034, 1990 WL 259675 (W.D. Ok. 1990).

[19] See the IRS Litigation Guideline Memorandum issued 8/12/92, 1992 LGM TL-68 (Rev) at 6-8, 1992 WL 1355877.

b. *Keener*'s Mischaracterization of these Claims Splits With the Fifth Circuit

Keener dismissed the §6621(c) claims on an erroneous assumption. In construing the partners' acknowledgment that all FPAA grounds for adjustment are considered for purposes of making a §6621(c) determination in the absence of a re-determination, *Keener* erroneously found that the "[t]axpayers *concede* that the FPAAs are conclusive." App. 15-16. [Emphasis added.] The Federal Circuit only looked to sham transaction from among the 14 grounds for adjustment in the FPAAs and adopted the Government's mischaracterization of the claims – "[t]axpayer's refund claims are based on the assertion that the partnerships' transactions are not shams," which it determined was a partnership item. App. 13-14.

But the partners made no such concession or assertion. Moreover, the alleged concession would not support penalty interest because the regulation prohibits selective reliance on TMT grounds. *Keener* ignored the controlling regulation and erred in its characterization of the claim.

These claims do not challenge the underlying partnership item adjustments, nor seek a redetermination of their character as sham or otherwise. A review of the claims clearly shows that they asserted they are due refunds because the IRS failed to properly apply §6621(c) and the regulation. App. 137, 180-82. The partners' claims do not even contain the word sham. App. 220-255.

c. *Keener* Splits the Circuits on §6621(c) Claim Jurisdiction

In *Field*, the Second Circuit set out three reasons why §7422(h) does not bar §6621(c) refund claims. App. 53-55.

First, §6621(c) is not a partnership item. It is not required to be taken into account on the partnership's return for the partnership's taxable year. It is in subtitle F,

not subtitle A. And it is not properly designated by regulation. The legislative history to the 1997 §6221 amendment confirms the correctness of this approach, noting penalties were not previously included in the definition of "partnership item" because they are in subtitle F, not subtitle A. H.R.Rep.No. 105-148 at 593-4.

Second, established precedent recognizes that §6621(c) is an affected item. *Citing Affiliated Equip. Leasing II v. C.I.R.*, 97 T.C. 575, 576-78 (1991); *Barlow v. C.I.R.*, T.C.Memo 2000-399, 2000 WL 1649506, *47-*51 (T.C. 2000); and *N.C.F. Energy Partners v. C.I.R.*, 89 T.C. 741, 745-6 (1987).

Third, the Government conceded at oral argument in *Field* that §6621(c) is an affected item, not a partnership item. Over 20 years ago, the Government first asserted §6621(c) was an affected item over which the Tax Court lacked jurisdiction in a partnership-level suit and which could only be determined in subsequent partner-level proceedings. *N.C.F. Energy*, at 745-6.

The Second Circuit also explained that §7422(h)'s jurisdictional bar applies only if the refund is directly based on the assessment of a partnership item. App 53-55.

In *Prochorenko*, the Federal Circuit adopted the Second Circuit's approach to §7422(h). *Prochorenko* found the claim in that case (i) was based on §6224(c) consistent settlement rights, an affected item, (ii) did not challenge the treatment of any partnership items, and, thus, (iii) was not barred by §7422(h). *Citing Monti v. U.S.*, 223 F.3d 6 (2nd Cir. 2000). App. 96-98. *Prochorenko* relied on the Second Circuit's observation that "at some level of generality, most refund claims for partnership taxes can be characterized as a refund 'attributable to partnership items,'" and held that construing that phrase so broadly would be contrary to the system of separate treatment of partnership items and affected items established by Congress. App. 97-98.

Affected items, including §6621(c), have both partnership item and non-partnership item components, requiring both partnership item and non-partnership item determinations.[20] *If* Keener and the Smiths' refund claims challenged the merits of any underlying partnership-item components, they would be barred by §7422(h). But their claims expressly "concede[] that the partnership items should, in fact, be adjusted as agreed on the Form 870-P(AD)." App. 188-89, 193-94, 199, 205, 210-11, 213, 216-17. Their claims assert the IRS improperly imposed §6621(c) penalty interest because when the statute and regulation are properly applied no part of their underpayment was "attributable to" a TMT. App. 189-90, 194-95, 199-200, 205-06, 211-12, 214-15, 217-18.

A broad reading of the Federal Circuit's holding in *Keener*, as in *Prati*, expands the §7422(h) jurisdictional bar to every affected item refund claim.

d. *Keener* Denies Any Forum to Challenge the IRS's Improper Imposition of §6621(c) Penalty Interest

The Sixth Circuit has held that the lack of a *pre*-payment forum respecting §6621(c) does not violate taxpayer due process rights because taxpayers have a *post*-payment refund forum. App. 156.

But *Keener* denies taxpayers that refund forum. *Keener* failed to address the lack of pre-payment jurisdiction at the partnership level and, broadly read, deprives taxpayer-partners of a post-payment forum when the IRS erroneously imposes §6621(c) (or for that matter makes any other affected item assessment). Denial of any forum violates the partners' First Amendment right to petition and Fifth

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[20] *E.g.*, a partner's §465 "amount at risk" may involve partnership debt (partnership item) and the amount of that debt personally assumed (non-partnership item).

Amendment due process protections. App. 165.

The Ninth Circuit recently addressed this issue in *Keller*. There the Tax Court found the underlying partnership-level proceeding concluded without §6621(c) findings, but the IRS assessed penalty interest nonetheless. The Tax Court held it did not have jurisdiction to determine if §6621(c) applied in a partner-level suit after *River City*. App. 71.

The Ninth Circuit, however, distinguished *River City* and held the Tax Court had residual jurisdiction to make a §6621(c) determination based on a review of the established prior record in the Hoyt Partnership cases. App. 84-85. It concluded that denying partner-level review would have the net result that the taxpayers owed penalty interest without any court having specifically ruled on any aspect of that interest. App. 84.

Keller is consistent with Keener and the Smiths' position. But in *Keener* it is still impossible to make an "attributable to" TMT determination because the settlements did not identify any grounds for the agreed partnership item adjustments. Consequently, the regulation must be applied using all FPAA grounds for adjustment, TMT and non-TMT.

Further, unlike *Keller*, here the TMT "sham" ground is logically inconsistent with the settlements. Those agreements allow roughly 50% of the deductions. *Rink v. C.I.R.*, 47 F.3d 168, 172 (6th Cir. 1995). And, as the Eleventh Circuit held, the nature and characterization of a partnership item cannot be separated from or be inconsistent with the underlying adjustment. *Fickling*, at 1305.

In *Fickling*, the IRS and taxpayers settled the tax treatment of debentures allowing 70% of the deductions. The taxpayers later sought a greater benefit by asserting

the debentures should have been disallowed as shams. The IRS and court denied that claim because (i) the 70% allowance demonstrated the transactions were not shams, and (ii) the settlement was non-committal on which of the IRS's three grounds the adjustment was based, belying that the IRS considered the transaction a sham. *Fickling* refused to look behind the settlement and recast the transaction inconsistent with the 70% allowance.

As Judge Whitaker concurred in *Law*, reopening the record to establish grounds necessary to apply §6621(c) is inconsistent with justice or judicial economy. He noted the statutory intent behind §6621(c) was to assist the court in managing its backlog and that the "*in terrorem*" effect of the statute is not served by allowing the Government to retroactively impose §6621(c) after settlement or conclusion of the proceedings and doing so could be seen as simply abusive. *Law*, at 994-95.

e. This Court Should Resolve the Split Between the Fifth and Federal Circuits Over Application of *Irom*'s "Separability Test"

In *Irom* – a pre-TEFRA, non-partnership, *pro se* §6621(c) case – the Tax Court disallowed a deduction based on a non-TMT ground advanced by the Government in the deficiency notice (akin to an FPAA) and on summary judgment. The Government sought a §6621(c) determination on the grounds that the loss was disallowed under "at risk," a TMT that had not been expressly raised in the deficiency notice or raised as a ground for the underpayment adjustment in the summary judgment motion. The Tax Court declined to impose §6621(c) based on "at risk" because it has not been raised or decided in the deficiency decision. App. 58-9.

The Second Circuit held that even though the Tax Court found an underpayment on the non-TMT ground, it should have considered whether the underpayment was "capable of being attributed to" the "at risk" TMT ground also.

App. 59.

Irom then distinguished the Fifth Circuit's *Todd* opinion, noting that the ground for disallowance there (a non-TMT) was "wholly separable" from another proposed TMT ground for the same adjustment. In contrast, the Second Circuit noted that the non-TMT determination in *Irom* also supported and was "inseparable" from a finding that the transaction was "at risk." App. 60. As restated in *Weiner*, under the *Irom* "separability test," if there are two grounds for an underpayment, one TMT and the other not, and the two grounds are "inseparable," then the formula in the regulation does not apply. App. 141.

But *Irom* also acknowledged that, as in *Todd*, a "similar subtraction," *i.e.*, the regulation's formula, controls how much of an underpayment is subject to §6621(c) if there are separable TMT and non-TMT grounds for adjustment. App. 61.

In keeping with Congressional intent to use the threat of §6621(c) as an incentive to encourage taxpayers to settle and reduce the Tax Court's docket, *Weiner* rebuffed the broad "capable of being attributed to" approach and reaffirmed *Todd*. App. 141. As *Weiner* noted:

> it follows that when the FPAA lists several *independent* reasons for disallowing the taxpayers' deductions, there is no way to determine, without additional superfluous litigation, whether the taxpayers' underpayment is "attributable to" a reason that also qualifies as a tax-motivated transaction (such as a sham). App. 141. [Emphasis added].

Weiner also examined and flatly rejected *Irom*'s "separability test" based on the facts of the case and as a matter of law. The Fifth Circuit found that two of the FPAA grounds for adjustment are non-TMTs – "not trade or

business" and "not ordinary and necessary under §162" – and that as a matter of law, those two non-TMT grounds are "separable" from a finding of sham. App. 141. These same three grounds are common to all the AMCOR FPAAs, including Keener's and the Smiths'. App. 220-255.

Even under *Irom*, where there are TMT and non-TMT grounds, §6621(c) cannot apply unless either: (i) the court adopts the "capable of being attributed to" definition of "attributable to", or (ii) all of the grounds in the FPAA are determined to be inseparable.

Keener erroneously assumed, without explanation or analysis, that the multiple TMT and non-TMT grounds listed in the FPAAs are "inseparable." *Keener* conspicuously ignored and failed to distinguish the Fifth Circuit's findings and holdings on substantively identical AMCOR FPAAs, settlements, and refunds claims. App. 16. *Keener*'s erroneous *Irom* determination is actually the cornerstone of that court's erroneous jurisdictional analysis.

Certiorari should be granted to provide crucial guidance to the courts on how and when to properly apply the regulation in the hundreds and perhaps thousands of remaining §6621(c) cases.

f. The Questions Presented are Recurring and of Substantial Importance in the Orderly Administration of the Tax Laws

Keener currently affects thousands of partners with the very real potential to affect thousands more.

i. <u>The §6621(c) Questions are Recurring</u>

There are many AMCOR related refund suits currently pending before the district courts of the Fifth Circuit, the Court of Federal Claims, and the Federal Circuit. Counsel for Keener and the Smiths represent many more partners with similar refund claims but where no suits have been

filed.

In addition, the IRS assessed §6621(c) penalty interest against hundreds of partners in the Elektra partnerships,[21] and thousands of partners in over 100 Hoyt Partnership partnerships. *River City Ranches # 1 Ltd. v. C.I.R* ., T.C. Memo, 2007-171, 2007 WL 1891595, *2 (2007). It is likely there are thousands more §6621(c) claims arising out of other investment programs. This opinion is important regarding not only the repealed §6621(c) affected item but potentially refund claims regarding all affected item assessments.

When Congress repealed §6621(c) and restructured the accuracy related penalties it noted they were a "morass of inconsistency and irrationality" [22] that were "determined too routinely and automatically by the IRS" in contravention of the original intent to encourage settlement and avoid imposition of those penalties [23] and discouraged rather than encouraged compliance. Congress was appalled that "hapless taxpayer[s] [could find themselves] confronting ... penalties and interest ... piled on to the

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[21] See *Vulcan Oil Technology Partners v. C.I.R.*, 110 T.C. 153 (1998); *Copeland, supra.*; *McGann v. U.S.* , 76 Fed.Cl. 745 (2007); *McGann v. U.S.*, 81 Fed.Cl. 642 (2008); *Bartimmo v. U.S.* , 525 F.Supp.2d 879 (S.D.Tex. 2007).

[22] Statement by Senator Pryor introducing S.1784 at 135 Cong. Rec. S13893-7 (October 24, 1989), 1989 WL 186980 (Cong.Rec.). S.1784 was ultimately enacted as a part of P.L. 101-239.

[23] H.R.Rep. No. 101-247, 1388, 1393, 1394, 1989 WL 168143 (Leg.Hist.), **2863,*1393; 135 Cong.Rec. S13057-03, 1989 WL 195142 (Cong.Rec.) *S13175, *cited by Copeland*, at n.10 (recognizing that §6621(c) had been repealed as a part of the accuracy related penalty provisions).

extent that they are twice the amount of tax in dispute."[24] But the IRS still imposes that disfavored provision for pre-1990 tax years. Consequently, repeal did not diminish the potential for recurrence or lessen the merit of this case for review. *C.I.R. v. Acker*, 361 U.S. 87, 89-90 n. 3 (1959) (*certiorari* warranted even though provision repealed because "the question is still a live one because of the pendency of a substantial number of cases which arose under and are governed by the 1939 Code.").

ii. *Keener* Undermines the Orderly Administration of the Tax Laws

This Court has long recognized the importance of the orderly administration of the federal tax laws. *U.S. v. Vermont*, 377 U.S. 351, 353 (1964).

The Court of Federal Claims has national jurisdiction and regularly addresses claims for refund of tax and interest and TEFRA partnership-level suits. It is, therefore, uniquely situated to advance the orderly administration of the tax laws by addressing large numbers of cases for geographically scattered taxpayers where substantively similar facts are subject to the same legal analysis under TEFRA and other federal tax provisions.

By denying partners this nationwide forum to raise their claims, the Federal Circuit has ensured that substantively similar facts and legal arguments will instead arise in every regional circuit. This virtually guarantees future conflicts over §6621(c) that will inevitably be presented for this Court's review. *C.I.R. v. Hansen*, 360 U.S. 446, 450 (1959) (*certiorari* warranted where conflicting decisions in income tax cases had similar facts and same issue and because of importance of question to proper

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[24] Statement by Senator Pryor, *supra*. Here the interest imposed averaged roughly 300% of the tax.

administration of revenue laws). Alternatively, if the same determination regarding jurisdiction is made by the various Circuit Courts of Appeal, the partners will be left with no remedy at all when §6621(c) or other affected item assessments are erroneously made.

iii. *Keener* Imposes Disparate Treatment on Similarly Situated Taxpayers

This Court has long recognized the special need for uniform rules with respect to federal taxation. *C.I.R. v. Bilder,* 369 U.S. 499, 501 (1962) (Harlan, J.); *C.I.R. v. Sunnen*, 333 U.S. 591, 599 (1948). (It is well settled that where one taxpayer "is accorded a tax treatment different from that given to other taxpayers of the same class ... there are inequalities in the administration of the revenue laws, discriminatory distinctions in tax liability, and a fertile basis for litigious confusion.").

Weiner, the Kracmers, and many AMCOR partners have already received their §6621(c) refunds and Agreed Final Judgments have been entered for another 21 partners in Keener and the Smiths' partnerships. App. 184-7.

Disparate treatment is especially egregious where, as here, it is applied to partners whose tax liabilities are attributable to the same or substantively similar partnership items, who settled with the IRS on the same terms, and whose disparate treatment is solely due to a happenstance of geography.

g. This Case Affords an Excellent Opportunity for This Court to Resolve Important Tax Issues, Circumvent Future Circuit Splits, Discourage Forum-Shopping and Resolve the Appearance of an Intra-Circuit Split

Keener denies partners a nationwide forum in which to present their §6621(c) claims. Denial of a nationwide forum also discourages small dollar partners from banding

together to reduce the high litigation costs of individually pursuing common claims.

Keener is an enticement to forum shop. *Keener* bars §6621(c) and possibly all affected item refund claims. The Fifth Circuit holds that AMCOR partners are entitled to refund of their §6621(c) payments. The split encourages partners with high dollar §6621(c) claims to establish residency, *albeit* temporarily, in the Fifth Circuit to pursuing their §6621(c) claims.

Under the broad *Keener* interpretation, the Court of Federal Claims appears to have an intra-court split as to whether it has jurisdiction to address §6621(c) claims. *Keener* holds that it does not have jurisdiction over §6621(c) claims for AMCOR partners. But in *McGann v. U.S.*, 76 Fed.Cl. 745 (2007), the court held that it does have jurisdiction over §6621(c) refund claims for Elektra partners. While the *Keener* appeal was pending the Government chose to voluntarily dismiss its Federal Circuit appeal in *McGann*.

Although the AMCOR and Elektra cases have different underlying bases for imposing §6621(c), 33 of the dismissed AMCOR cases before the Federal Circuit are procedurally almost identical to *McGann* and the Elektra cases, *i.e.* based on Tax Court decisions, not settlements. There is no clear explanation for why the Court of Federal Claims holds that some partners are entitled to refund of their §6621(c) payments as a matter of law and others have the court's door closed in their face before they can even raise the issue.

This case cleanly presents the legal issues. Clarifying these issues now would greatly assist both the IRS in administering §6621(c) and thousands of taxpayers trapped in this technical quagmire.

2. Statute of Limitations

a. This Issue is Important and Warrants Review

i. The Federal Circuit's Decision Violates Keener and the Smiths' Right to Petition and Due Process Guarantees

Under TEFRA, partnership items are determined *only* at the partnership level. §6221. App. 166. *Keener* held that claims based on assessment after the assessment period expired were attributable to a partnership item and, therefore, could not be heard in the partner-level refund suits. App. 9-10. The only other court that could, arguably, have addressed the limitations period to assess a partner's resulting tax liability was the Tax Court in the partnership-level suits. But both the partners and their limitations defense were barred by statute from those proceedings.

In partnership-level suits for pre-1997 tax years, partners with expired assessment periods *cannot* be parties to the proceeding. §6226(c), (d)(1)(B). App. 168. Here it is undisputed that (i) the partners' assessment periods expired in 1988 and 1989, unless an exception to §6229(a) applies, and (ii) the partners' settlements did not waive or otherwise alter the statutory period.[25] Therefore, §6226(d)(1)(B) barred Keener and the Smiths from participating in or being bound by the partnership-level suits.[26]

If *Keener* is correct and the partners' were allowed to

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[25] Once assessment periods expire they may be waived by express agreement but cannot be revived. §6229(b). App.169.

[26] Congress amended §6226(d)(1) and §6226(f), allowing at least some limitations defenses in partnership-level suits and granting courts in partnership-level suits limited jurisdiction over more issues, none applicable here – but only for tax years after August 5, 1997. H.R.Rep.No. 105-148 at 593-4. Those amendments are inapplicable here.

raise their limitations defense in the partnership-level suits, then §6226(d)(1)(B) is superfluous, which this Court disfavors. *Freytag v. C.I.R.*, 501 U.S. 868, 877 (1991). The Federal Circuit and *every one* of the "legion" of courts it joins in this holding have conspicuously failed to address the effect of §6226(d)(1)(B) for pre-1997 tax years.

Even if the partners could validly have participated in the partnership-level suits, they could not have raised their limitations defense to assessment because the Tax Court lacked jurisdiction to determine its non-partnership item components(*e.g.* §§ 6229(b)(1)(A), 6501(a), 6501(c)(3)). App. 169, 174. For tax years 1984-1986, the jurisdiction of the Tax Court in §6226 partnership-level suits is restricted to determining §6231(a)(3) "partnership items" and their allocation among the partners. §6226(f). App. 168.

Keener means that, at least for pre-1997 tax years, partners have *no* court of competent jurisdiction in which to raise their limitations defense or seek refunds, which violates their First Amendment right to petition for legal redress of claims with reasonable bases in law and fact. *BE & K Constr. Co. v. N.L.R.B.* , 536 U.S. 516, 524-25 (2002). Further, *Keener*'s rationale results in an improper regulatory taking of their intangible property, *i.e.* their limitations claims, violating their Fifth Amendment due process guarantees. *Ruckelshaus v. Monsanto Co.,* 467 U.S. 986, 1003-04 (1984).

If a partner's assessment period is deemed a partnership item, §6226(d)(1)(B) will always cause constitutional conflicts for partners with expired assessment periods. Likewise, if §7422(h) bars partners from raising their limitations claims in partner-level suits, then §6226(f) will always cause a constitutional conflict.

Congress restricted "partnership items" to only those items to be allocated by the partnership to the partners, which avoids encroaching on constitutional safeguards. By

statute, all other items, including all subtitle F procedural issues, remained subject to the subchapter B (partner-level) procedures. §6230(a). App. 171. This is the only interpretation that validates §6226(d)(1)(B) and creates no constitutional conflict.

If the partners' assessment periods are correctly recognized as either non-partnership or affected items, then §7422(h) cannot bar jurisdiction in a partner-level refund suit (but any partnership item component can only be applied and not redetermined), the Court of Federal Claims has jurisdiction to consider their claims, and the constitutional violations become moot as to Keener and the Smiths.

ii. This Issue is Recurring

This issue affects far more taxpayers than even the §6621(c) penalty interest issue above because it affects all partnerships (not just those where the IRS imposes §6621(c)) for tax years 1982-1996 (not just 1982-1989).

This issue will recur in the AMCOR cases and others until the obviously unconstitutional conflicts resulting from the interaction of *Keener*'s erroneous interpretation of the facts, the law, and the plain language of §6226(d)(1)(B) and §6226(f) for the tax years in issue is resolved.

iii. *Keener* Undermines the Orderly Administration of the Tax Laws

For 1984 and 1985, partners whose assessment periods have expired *cannot* be parties to the §6226 partnership-level suits. §6226(d)(1)(B). Even if they mistakenly try to participate they cannot be bound by the outcome. Tax Court jurisdiction can only by created by Congress, not by erroneous acquiescence. §§7441, §7442. App. 177. *Whalen v. C.I.R.*, T.C.Memo 2009-37, 2009 WL 383019, *5 (Tax Court is an Article I court with jurisdiction only as expressly prescribed by Congress that cannot be expanded by the

parties' agreement or *sua sponte* by the court).

Keener's limitations analysis disregarding §6226(d)(1)(B) pointlessly clouds one of the few straightforward provisions in an otherwise byzantine procedural scheme. App. 168.

The §6231(a)(3) definition of "partnership item" is the lynchpin of Congress's entire TEFRA procedural scheme. The Federal Circuit's determination – the first by any court – that §6231(a)(3) is ambiguous fractures TEFRA even further and should be overturned by this Court.

b. This Case Affords an Excellent Opportunity to Resolve This Important Tax Issue

This issue presents a straightforward question of statutory construction: Is the period for the IRS to assess taxes arising from partnership items a §6231(a)(3) partnership item? If so, does §7422(h) bar the federal district courts and the Court of Federal Claims from hearing the partners' refund suit based on an assessment made after limitations expired?

c. *Keener* Was Wrongly Decided

The cornerstone of TEFRA's procedural scheme is the creation of three categories: partnership items, non-partnership items, and affected items (non-partnership items that are affected by partnership items). §6231(a)(3), (4), and (5). App. 173. Partnership items can only be adjusted in partnership-level proceedings. §6221. App. 166. Non-partnership items are adjusted in subsequent partner-level proceedings including applying the previously adjusted partnership item components of any affected items. *Weiner* at App. 131.

Section 7422(h) bars jurisdiction in subsequent partner-level suits over any "refund attributable to [§6231(a)(3)] partnership items." App. 177. But merely being a partnership-level *issue* is insufficient to make something a

partnership item. In §6231(a)(3) Congress imposed *three* requirements restricting partnership items to

> any item [1] required to be taken into account for the partnership's taxable year [2] under any provision of subtitle A [3] to the extent regulations prescribed by the Secretary provide that, for the purposes of [subtitle F], such item is more appropriately determined at the partnership level than at the partner level.

See also *Field* at App.53 and *Prochorenko* at App. 96-7.

The IRS has three years from the later of the date a taxpayer files his return or is due to file his return to assess additional tax for that year. §6501(a), and (c)(3). App. 174. For partnership item related assessments, §6229(a) extends the period until three years after the partnership files its return. App. 169. An FPAA issued within the §6229(a) period further extends the period until after the partnership-level proceedings are concluded. §§6229(d),(f), 6231(b)(1)(C). App. 170, 173. Consequently, each partner may have a different assessment deadline.

Under §6231(a)(3)'s plain language, a partner's assessment period and each of its components are non-partnership items. Section 6229(a), and every other component of a partner's assessment period, is in subtitle F (§§6001-7873), not subtitle A (§§1-1563). §§6229(a), (b), §6229(c)(3), (d), 6501(a) and (c)(3). App. 169-70, 174. And the Secretary has never prescribed limitations or any of its elements as partnership items by regulation.

Keener "join[ed] a 'legion' of other courts who, *while adopting different rationales*, have found that this limitations claim cannot be raised in a partner-level proceeding." *Keener*, at App. 174. But this 'legion' of differing rationales evolved only because courts groped to justify a result they believed *ought to be* within a statutory

framework that, by its plain language, never intended that result.

In *Weiner*, the Fifth Circuit treated §6231(a)'s subtitle A requirement as irrelevant "because the FPAA limitations issue affects the partnership as a whole." *Weiner* at 156-57. App.131. Instead it relied on Treas. Reg. §301.6231(a)(3)-1(b):

> The term "partnership item" includes the accounting practices and the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc.

The Fifth Circuit overturned the trial court's correct recognition that the timing of an FPAA "is not of the same ilk as matters listed in §301.6231(a)(3)-1."[27] The Fifth Circuit acknowledged that the §6229(a) limitations issue is not expressly designated in the regulation but held that the regulation "is broad enough to include in its parameters legal and factual determinations *not* specifically found in subtitle A." *Weiner*, at App. 132, n.3. [Emphasis in original]. The Fifth Circuit then held that "this way, the treasury regulations have implicitly included the statute of limitations determination within the definition of 'partnership item.' " App. 132.

In *Keener*, the partners argued, *inter alia*, that (i) under *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984), a court may defer to an agency's regulation only if the statute is silent or ambiguous, and (ii) §301.6231(a)(3)-1(b) does not encompass either

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[27] *Weiner v. U.S.*, 255 F.Supp.2d 624, 635 (S.D.Tex. 2002), affirmed on other grounds 389 F.3d 152 (5th Cir. 2004). In other words, §6229(a) is an *assessment* procedure, it cannot affect the *amount* of the partnership items or the resulting tax.

limitations *in toto* or its §6229(a) component.

Keener held, for the first time anywhere, that §6231(a)(3) is ambiguous and, therefore, courts may defer to the Government's interpretation. *Keener*, at App. 9.

Keener is wrong because §6231(a)(3)'s plain language unambiguously evidences that Congress never intended the limitations period, any element thereof, or any subtitle F procedure to be partnership items.

The court's ambiguity determination is wrong because a statute is ambiguous only if there are multiple *reasonable* interpretations. *National R.R. Passenger Corp. v. Boston and Maine Corp.*, 503 U.S. 407, 417 (1992). *Keener* adopted without examination *Prati*'s interpretation that a partner's assessment deadline is a partnership item because it is an

> item required to be taken into account for the partnership's taxable year [as the term 'partnership taxable year' is used] under any provision of subtitle A ....

App. 9.

But this is not a reasonable interpretation. Regardless of subtitle A, the deadline for the IRS to assess against any individual partner is not required to be taken into account by the partnership in *any* taxable year. This interpretation is also unreasonable because it cannot be reconciled with the §§6226(d)(1)(B) and 6226(f) jurisdictional bars in partnership-level suits.

Similarly, *Keener*, *Prati*, and all other courts relying on Treas. Reg. §301.6231(a)(3)-1(b) were demonstrably wrong. The deadline to assess partnership item related taxes against an individual partner is irrelevant to "the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc." App. 183. *E.g.*, whether a single partner's assessment deadline is still open because he failed

to file his personal return for that tax year is irrelevant to the matters listed in the regulation. No court has ever explained how a partner's assessment period, or any element thereof, could possibly alter or adjust his partnership items. Only the *Weiner* trial court has correctly realized that neither the timing of an FPAA nor any other limitations element "is ... of the same ilk as matters listed in §301.6231(a)(3)-1." *Weiner*, 255 F.Supp.2d at 635.

Keener mistakenly stated that the partners "do not dispute that this regulation includes their limitations claim in its definition of 'partnership item' " and that they stipulated their limitations claim satisfied §6231(a)(3)'s first and third requirements. *Keener*, at App. 8. Keener and the Smiths never stipulated that their assessment deadlines meet §6231(a)(3)'s second and/or third requirement, or that if the regulation were correctly interpreted it includes their assessment deadlines. Keener and the Smiths have consistently maintained that their assessment deadlines fit neither the statutory requirements nor the types of items encompassed by the regulation.

Keener's contorted rationale to justify its ambiguity determination is both wrong and irrelevant. Wrong, because the only rational reading of the statute is that "under ... subtitle A," clearly modifies the phrase "any item required to be taken into account." To hold it modifies "the partnership's taxable year" renders it superfluous. There is no need for such modification. What constitutes a partnership's taxable year needs no words of limitation. It is consistent throughout the Code. These words of limitation must have meaning and intent. Whether they modify "any item" or "required to be taken into account" results in the same conclusion, for a partner's assessment period is neither set forth in subtitle A, not is it required to be taken into account for the partnership taxable year under subtitle A.

If §6229(a) or any of its elements is a partnership item, then a partner's assessment deadline is an affected item because it has partnership item [*e.g.* §6229(a)] and non-partnership item [*e.g.* §6501(a), and (c)(3)] components. §6231(a)(5). As such, §7422(h) cannot bar jurisdiction in partner-level refund suits over a partner's limitations claim because his refund is attributable to an affected item, not a partnership item.

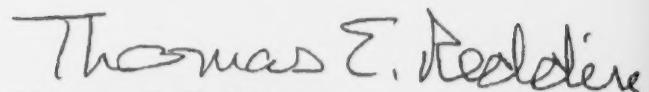
In partner-level affected item refund suits courts cannot *make new* partnership item determinations. They must *apply* determinations *already made* at the partnership level and by Congress, but they may make all relevant non-partnership item determinations. Keener and the Smiths have never *disputed* this, it is exactly what they have sought from day one. App.188-209.

CONCLUSION

Despite its repeal, the IRS's "draconian" imposition of §6621(c) penalty interest, as well as the limitations issues continue to plague taxpayers and the courts. Thousands of penalty interest refund claims have been affected by the fractured approach to this provision.

Review should be granted to address these significant issues as to the orderly administration of the tax laws and resolve the Circuit splits and disparate treatment of similarly situated taxpayers.

Respectfully submitted.



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JUNE 2009

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United States Court of Appeals
for the Federal Circuit

2008-5004

KENNETH C. KEENER, WILLIAM P. SMITH,
and ANNE D. SMITH,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Thomas E. Redding, Redding & Associates, P.C., of Houston, Texas, argued for plaintiffs-appellants. With him on the brief were Teresa J. Womack and Sallie W. Gladney.

Deborah K. Snyder, Attorney, Commercial Litigation Branch, Tax Division, Appellate Section, United States Department of Justice, of Washington, DC, argued for defendant-appellee. With her on the brief were Nathan J. Hochman, Assistant Attorney General, and Michael J. Haungs, Attorney.

Appealed from: United States Court of Federal Claims

Judge Francis M. Allegra

United States Court of Appeals
for the Federal Circuit

2008-5004

KENNETH C. KEENER, WILLIAM P. SMITH, and ANNE D. SMITH,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Appeal from the United States Court of Federal Claims in 03-CV-2028 and 04-CV-907, Judge Francis M. Allegra.

DECIDED: January 8, 2009

Before NEWMAN, PROST, and MOORE, Circuit Judges.

PROST, Circuit Judge.

Plaintiffs-Appellants Kenneth C. Keener, William P. Smith, and Anne D. Smith (collectively, "Taxpayers") brought suit against Defendant-Appellee the United States ("the Government") in the United States Court of Federal Claims seeking refunds of federal income taxes and interest paid in connection with their investments in various partnerships. The Government filed a motion to dismiss for lack of jurisdiction, asserting that I.R.C. §7422(h) foreclosed the court from exercising jurisdiction over Taxpayers' partnership-level challenges in this partner-level suit. The Court of Federal Claims agreed and dismissed Taxpayers' claims for lack of jurisdiction. Keener v. United States, 76 Fed. Cl. 455 (2007). We affirm.

BACKGROUND

Taxpayers invested in partnerships that were part of a larger organization called AMCOR.[1] During the early- to mid-1980s, "AMCOR was in the business of promoting tax shelter partnerships." Crop Assocs.-1986 v. Comm'r of Internal Revenue, 80 T.C.M. (CCH) 56, 59 (2000). In 1984 and 1985, the Taxpayers' partnerships reported ordinary loss deductions, which were apportioned among their partners. As a result, on their income tax returns for 1984 and 1985, Keener and Smith reported their shares of the losses and used those losses to offset their taxable income.

After examining the returns of these partnerships, the Internal Revenue Service ("IRS") issued a Notice of Final Partnership Administrative Adjustment ("FPAA") to each partnership in 1991. These FPAAs disallowed the ordinary loss deductions reported by each partnership in 1984 and 1985 and, as a result, reduced those deductions to zero. The FPAAs each stated that the deductions were "not allowable for the following reasons," which included, "The partnership's activities constitute a series of sham transactions."

In response, certain partners filed petitions in the Tax Court for readjustment of partnership items pursuant to I.R.C. §6226. Among other challenges, these petitions claimed that the period for assessing tax attributable to the adjusted partnership items had expired prior to issuance of the FPAAs and that the IRS had erred in determining that the partnerships' activities constituted a series of sham transactions. In order to end their involvement in these

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[1] Specifically, Mr. Keener was a limited partner in Agri-Venture-II during the 1984 tax year and a limited partner in Agri-Venture Fund during the 1985 tax year. Mr. Smith was a limited partner in Richgrove Grape Associates during the 1984 tax year and a limited partner in Desert Highlands Vineyards during the 1985 tax year.

suits,[2] Taxpayers offered to settle with the IRS by executing Forms 870-P(AD) ("Settlement Agreements"), and the IRS accepted these settlements. In the Settlement Agreements, Taxpayers were permitted to report a fraction of the previously disallowed losses, and, in return, Taxpayers agreed that "no claim for refund or credit based on any change in the treatment of partnership items may be filed or prosecuted." The Settlement Agreements made no mention of the "sham transaction" determination in the FPAA, but did specify that the settlements "may result in an additional tax liability to [Taxpayers] plus interest as provided by law." Thereafter, the IRS assessed additional tax and interest, including penalty interest pursuant to §6621(c), which Taxpayers paid in full.

Mr. Keener then filed administrative refund claims with the IRS in December 1999, and the Smiths filed administrative refund claims in March 2002. The IRS denied their claims, and Mr. Keener and the Smiths filed separate refund suits in the Court of Federal Claims, which were later consolidated. Keener, 76 Fed. Cl. at 457. After consolidation, the Government filed partial motions to dismiss, arguing that the Court of Federal Claims lacked jurisdiction under I.R.C. §7422(h). Id. The court granted the Government's motion, id. at 470, and, after the parties stipulated to a dismissal of the remaining issues with prejudice, entered final judgment. Taxpayers appealed to

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[2] Ultimately, on July 19, 2001, the Tax Court issued stipulated decisions in the partnership-level proceedings. These decisions found that the adjustments to partnership income and expense were attributable to transactions "which lacked economic substance," as described in former I.R.C. §6621(c)(3)(A)(v), "so as to result in a substantial distortion of [partnership income and/or expense]," as described in I.R.C. §6621(c)(3)(A)(iv). The decisions also determined that the provisions of I.R.C. §6229 did not bar the assessment of deficiencies in income tax attributable to the adjustments to partnership items.

this court, and we have jurisdiction pursuant to 28 U.S.C. §1295(a)(3).

DISCUSSION

"The Court of Federal Claims' decision to grant the Government's motion to dismiss for lack of jurisdiction is a matter of law, which this court reviews de novo." Mudge v. United States, 308 F.3d 1220, 1224 (Fed. Cir. 2002). As the party seeking the exercise of jurisdiction, Taxpayers have the burden of establishing that jurisdiction exists. Rocovich v. United States, 933 F.2d 991, 993 (Fed. Cir. 1991).

At the Court of Federal Claims, Taxpayers argued that they were entitled to refunds on two separate grounds. First, Taxpayers claimed that they were due refunds of tax and interest on the theory that the IRS assessed the tax and interest after the statute of limitations in I.R.C. §6229(a) expired. Second, and alternatively, Taxpayers claimed that they were due refunds of penalty interest—paid pursuant to I.R.C. §6621(c)—because their underpayments of tax were not attributable to "tax motivated transactions." The Government filed a motion to dismiss, arguing that I.R.C. §7422(h) deprives the Court of Federal Claims of jurisdiction over both of these claims, and the Court of Federal claims agreed, concluding that §7422(h) precluded jurisdiction because the Taxpayers' claims for refunds are "attributable to partnership items." Keener, 76 Fed. Cl. at 460, 469-70. After providing a brief overview of the relevant law, we evaluate the dismissal of each of Taxpayers' claims in turn.

A. Overview of TEFRA

As partnerships are pass-through entities that do not themselves pay tax, all income, deductions, and credits are allocated to the individual partners. I.R.C. §§701-702; Conway v. United States, 326 F.3d 1268, 1271 (Fed. Cir. 2003). Partnerships are required to file annual information returns reporting the partners' distributive shares of

income, gain, deductions or credits, I.R.C. § 6031, and the individual partners then report their distributive shares on their federal income tax returns, I.R.C. §§701-704.

In 1982, Congress enacted the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), Pub. L. No. 97-248, 96 Stat. 324. "TEFRA created a single unified procedure for determining the tax treatment of all partnership items at the partnership level, rather than separately at the partner level." In re Crowell, 305 F.3d 474, 478 (6th Cir. 2002); see AD Global Fund, LLC ex rel. North Hills Holding, Inc. v. United States, 481 F.3d 1351, 1355 (Fed. Cir. 2007) (TEFRA is "a statutory scheme that intends that adjustment to a partnership tax return be completed in one consistent proceeding before individual partners are assessed for partnership items."). Accordingly, whether a tax item is a "partnership item" governs how the TEFRA procedures apply. Significantly for this appeal, the code defines the terms "partnership item," "nonpartnership item," and "affected item" as follows:

> (3) Partnership item.--The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.
>
> (4) Nonpartnership item.--The term "nonpartnership item" means an item which is (or is treated as) not a partnership item.
>
> (5) Affected item.--The term "affected item" means any item to the extent such item is affected by a partnership item.

I.R.C. §6231(a).

B. Statute of Limitations Claim—I.R.C. §6229(a)

Taxpayers first argue that the Court of Federal Claims had jurisdiction over their refund claims that allege that the IRS assessed tax and interest after the statute of limitations in I.R.C. §6229(a) had expired. The Government argues that the Court of Federal Claims correctly determined that it lacked jurisdiction over Taxpayers' limitations claim because that claim is a challenge to a partnership item and TEFRA specifies that "[n]o action may be brought for a refund attributable to partnership items" (with exceptions not applicable here). I.R.C. §7422(h). In response, Taxpayers assert that this jurisdictional bar does not apply to their limitations claim because it is not a "partnership item."

As this dispute turns on the meaning of the term "partnership item," we look first to its statutory definition:

> The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

Id. at §6231(a)(3) (emphasis added). The relevant Treasury regulation further defines a "partnership item" to include "the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc." Treas. Reg. §301.6231(a)(3)-1(b) (emphasis added).

The Government argues that the limitations claim is a "partnership item" within the terms of the regulation because the statute of limitations "underlie[s] the determination of the amount, timing, and characterization of items of income, credit gain, loss, deduction, etc." See

Weiner v. United States, 389 F.3d 152, 157 (5th Cir. 2004) ("[T]he treasury regulations have implicitly included the statute of limitations determination within the definition of 'partnership item.'"); Slovacek v. United States, 36 Fed. Cl. 250, 255 (1996) (suggesting that the limitations claim "might be said to affect the amount, timing, and characterization of income, etc., (partnership items) at the partnership level, if only in a thumbs-up or thumbs-down manner"). Taxpayers do not dispute that this regulation includes their limitations claim in its definition of "partnership item."

Rather, Taxpayers argue that the regulation should not be given deference because the regulation's inclusion of the limitations claim in its definition of "partnership item" contradicts the plain language of the statute. See Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 843 (1984) (stating that a regulation adopting a "permissible construction" of a statute is due deference "if the statute is silent or ambiguous with respect to the specific issue"). Taxpayers assert that the statute defines the term "partnership item" to include only (1) items found in subtitle A that (2) must be taken into account for the partnership's taxable year and (3) are designated as "more appropriately determined at the partnership level." While stipulating that their limitations claim satisfies the latter two requirements, Taxpayers argue that the claim cannot be a "partnership item" because it fails to satisfy the first requirement. In other words, Taxpayers contend that because the provisions relevant to this claim—namely, §§6229(a) and 6501—are found in subtitle F of the code, rather than subtitle A, the claim cannot be considered a partnership item by definition. Because the statute is allegedly clear in this regard, Taxpayers argue that the Treasury regulation is invalid to the extent it defines "partnership item" to include any item outside subtitle A.

The ambiguity in the statutory definition, however, is illustrated by Prati v. United States, 81 Fed. Cl. 422 (2008), where the court adopted a different understanding of the statute's definition of "partnership item." Under that court's reading, the statute's phrase I.R.C. §6231(a)(3) (emphasis omitted)). That court's understanding "permits treating, as partnership items, any and all legal issues that influence the treatment of partnership items arising under subtitle A." "under any provision of subtitle A" modifies not "any [partnership] item" (as Taxpayers argue), but what immediately precedes it (i.e., "the partnership's taxable year"). Id. at 430-31 (citing William Strunk Jr. & E.B. White, The Elements of Style 4-5, 59 (4th ed. 1999) (identifying rule of grammar that a restrictive clause limits or defines what immediately precedes it and is not set-off by a comma)). The court noted that this understanding "makes eminent sense because while subtitle A encompasses substantive rules for a partner's income tax, subtitle A's provisions make clear that this income is derived from the partnership during the partnership's taxable year, as defined by this subtitle." Id. at 431. Under this reading, a "partnership item" would be anything that affects—or, in other words, is "required to be taken into account for"—the partnership's taxable year. Id. (quoting Id. at 432. Also, under this reading a "partnership item" could include items outside subtitle A.

Because we are presented with these different interpretations, we hold that the statute does not unambiguously answer the question of whether a provision outside of subtitle A can be a "partnership item." See GHS Health Maint. Org., Inc. v. United States, 536 F.3d 1293, 1297 (Fed. Cir. 2008) ("Identifying 'the precise question at issue' is a necessary prerequisite to determining whether or not Congress has directly spoken on it."). In light of this ambiguity, we conclude that the Government's interpretation of the statute is, at a minimum, a reasonable one. Since the statute is ambiguous with respect to this

issue, we give deference to the agency's interpretation of the statute. Chevron, 467 U.S. at 843. As noted above, Taxpayers do not dispute that the regulation's definition of "partnership item" includes their limitations claim. Thus, the Court of Federal Claims correctly determined that it lacked jurisdiction over the limitations claim.[3]

We note, moreover, that the interpretation of the statutory language outlined in Prati is more reasonable and appropriate given the structure established by TEFRA. As noted above, TEFRA is "a statutory scheme that intends that adjustment to a partnership tax return be completed in one consistent proceeding before individual partners are assessed for partnership items." AD Global Fund, 481 F.3d at 1355. To remain consistent with this structure, the limitations claim raised by Taxpayers should not be litigated in a partner-level proceeding because it affects the partnership as a whole. Weiner, 389 F.3d at 156-57. Moreover, to allow a taxpayer to raise this argument in a partner-level proceeding "would undermine TEFRA's dual goals of centralizing the treatment of partnership items and ensuring the equal treatment of partners." Chimblo, 177 F.3d at 125.

In addition, Taxpayers' proffered interpretation of the statutory definition—which categorically excludes anything in subtitles B-J from the definition of "partnership item"—makes little sense given the framework established by TEFRA. Subtitle F of the Code, titled "Procedure and

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[3] With this result, we join a "legion" of other courts who, while adopting different rationales, have found that this limitations claim cannot be raised in a partner-level proceeding. Keener, 76 Fed. Cl. at 463 (citing Weiner, 389 F.3d at 156-57; Davenport Recycling Assocs. v. Comm'r of Internal Revenue, 220 F.3d 1255, 1260 (11th Cir. 2000); Williams v. United States, 165 F.3d 30 (6th Cir. 1998) (Table); Kaplan v. United States, 133 F.3d 469, 473 (7th Cir. 1998); Crowell v. Comm'r of Internal Revenue, 102 T.C. 683, 693 (1994)); see also Chimblo v. Comm'r of Internal Revenue, 177 F.3d 119, 125 (2d Cir. 1999).

Administration," includes subchapter C, which is titled "Tax Treatment of Partnership Items." (Emphasis added). This subchapter includes rules relating to the treatment of partnership items (e.g., §§6221, 6229, and 6231), and, if we were to adopt Taxpayers' definition of "partnership item," these procedures for dealing with partnership items would not, themselves, be partnership items. The result would be that a partnership-level proceeding would not adjudicate these issues, instead leaving them to a plurality of potentially inconsistent partner-level proceedings. See I.R.C. §6221 ("[T]he tax treatment of any partnership item shall be determined at the partnership level."). Like other courts,[4] we reject this impractical result. See River City Ranches # 1 Ltd. v. Comm'r of Internal Revenue, 401 F.3d 1136, 1144 (9th Cir. 2005) ("A partnership's tax items . . . are litigated in partnership proceedings—not in the individual partners' cases.").

C. Penalty Interest Claim—I.R.C. §6621(c)

Second, Taxpayers requested refunds of penalty interest paid pursuant to I.R.C. §6621(c). Section 6621(c), which was in effect for the years at issue,[5] imposed an interest rate of 120% of the statutory rate on "any substantial

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[4] Indeed, as noted above, the Tax Court, when dealing with Taxpayers' partner-level suit, already addressed this limitations claim, albeit after these particular partners settled with the IRS. Agri-Cal Venture Assocs. v. Comm'r of Internal Revenue, 80 T.C.M. (CCH) 295 (2000).

[5] Former §6621(c), originally codified I.R.C. §6621(d), was added to the tax code in 1984 and applies to interest accruing after December 31, 1984. Tax Reform Act of 1984, Pub. L. No. 98-369, Div. A, §144, 98 Stat. 494 (adding provision to tax code); Tax Reform Act of 1986, Pub. L. No. 99-514, §1511(c)(1), 100 Stat. 2085 (amending and recodifying). Although this version of §6621(c) was repealed in 1990, it remains applicable for the tax years at issue in this case. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, §11341, 104 Stat. 1388 (specifying amendment and effective date).

underpayment attributable to tax motivated transactions." I.R.C. §6621(c)(1).

> [T]he term "substantial underpayment attributable to tax motivated transactions" means any underpayment of taxes imposed by subtitle A . . . which is attributable to 1 or more tax motivated transactions if the amount of the underpayment . . . exceeds $1,000.

Id. at §6621(c)(2). The statute defines a "tax motivated transaction" to include "any sham or fraudulent transaction." Id. at §6621(c)(3)(A)(v).

In this case, the FPAAs issued by the IRS disallowed the ordinary loss deductions reported by the partnerships and explained that these deductions were "not allowable" for several reasons, including a determination that "[t]he partnership's activities constitute[d] a series of sham transactions." After partner-level suits followed these FPAAs, Taxpayers chose to settle with the IRS. The Settlement Agreements made no mention of the "sham transaction" determinations in the FPAAs and stated that the settlements "may result in an additional tax liability to [Taxpayers] plus interest as provided by law." The IRS later assessed additional tax and interest, including penalty interest pursuant to §6621(c), which Taxpayers paid.

Now arguing that they are entitled to a refund, Taxpayers assert that their underpayments of taxes were not attributable to "tax motivated transactions" and, thus, that the IRS improperly imposed penalty interest under this section. The Government responds that the Court of Federal Claims correctly concluded that it lacks jurisdiction over this claim for a refund because it is "attributable to partnership items." See I.R.C. §7422(h). Noting that Taxpayers' arguments are focused on determining whether or not the partnerships' transactions were "tax motivated," the Government argues that—because the nature of the

partnerships' transactions is a partnership item—Taxpayers' claims are based on the determination of a partnership item. Thus, the Government concludes, Taxpayers' claims are "quintessential claims for a refund 'attributable to partnership items'" and are barred by §7422(h). We agree.

As noted above, §7422(h) provides that "[n]o action may be brought for a refund attributable to partnership items . . . except as provided in section 6228(b) or section 6230(c)." I.R.C. §7422(h) (emphasis added). "The phrase 'attributable to,' . . . is not defined anywhere in the Code and has no special technical meaning under the tax laws. Courts in various tax cases have construed the phrase according to its plain meaning, which is understood to be 'due to, caused by, or generated by.'" Electrolux Holdings, Inc. v. United States, 491 F.3d 1327, 1330-31 (Fed. Cir. 2007) (internal citations omitted) (addressing meaning of the phrase in §6511(d)(2)(A)). Thus, the applicability of §7422(h) turns on whether Taxpayers' refund claims are "due to, caused by, or generated by" a partnership item.

As the Government correctly notes, Taxpayers' refund claims are based on the assertion that the partnerships' transactions were not shams. This characterization of a partnership's transaction is a partnership item: [6] it bears directly on the validity of the deductions claimed by the

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[6] The Government identifies numerous circuit courts in accord. See, e.g., Nault v. United States, 517 F.3d 2, 8 (1st Cir. 2008) (noting that the court lacked jurisdiction "to determine whether the relevant transactions actually did have economic substance"); RJT Invs. X v. Comm'r of Internal Revenue, 491 F.3d 732, 736-38 (8th Cir. 2007) (status of partnership as a sham is a partnership item); River City Ranches, 401 F.3d at 1143-44; Randell v. United States, 64 F.3d 101, 107-08 (2d Cir. 1995) (court lacked jurisdiction to consider taxpayer's argument that partnership income was a sham). Moreover, Taxpayers do not dispute this characterization and even expressly concede that the nature of a partnership item is a partnership item.

partnership; it affects the tax treatment of other partnership item entries; and it can even dictate whether certain income tax concepts are applicable. See I.R.C. §6221 ("[T]he tax treatment of any partnership item shall be determined at the partnership level."); Treas. Reg. §301.6231(a)(3)-1(b) (defining "partnership item" to include "the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit gain, loss, deduction, etc."); River City Ranches, 401 F.3d at 1143-44 ("The nature of the partnerships' transactions is . . . 'required to be taken into account . . . under . . . [the income tax provisions of] subtitle A.'" (alterations in original) (quoting I.R.C. §6231(a)(3))). Moreover, the nature of a partnership's transaction affects all partners and is not dependent on facts unique to a particular partner. Cf. Prochorenko v. United States, 243 F.3d 1359, 1363 (Fed. Cir. 2001) (finding jurisdiction when issue was "entirely dependent on [the taxpayers'] own unique factual circumstances"). Thus, the nature of a partnership's transaction—and, specifically, whether a partnership transaction is a "sham"—is a partnership item.

Accordingly, because Taxpayers are requesting a refund based on the nature of the partnerships' transactions and because the nature of a partnership's transaction is a partnership item, Taxpayers' claims are "attributable to" partnership items. Cf. id. (finding that refund was not "attributable to partnership items" where it was "based on" a nonpartnership item). Accordingly, the Court of Federal Claims correctly determined that it lacks jurisdiction over Taxpayers' claim "for a refund attributable to partnership items." I.R.C. §7422(h).

In an attempt to avoid this result, Taxpayers recharacterize their claims as general claims for a refund of §6621(c) penalty interest—which, they assert, is an affected item and not a partnership item—and argue that §7422(h) does not bar refund claims for affected items. Taxpayers

explain that an affected item—defined by statute as "any item to the extent such item is affected by a partnership item," I.R.C. §6231(a)(5)—includes both a partnership-level component (requiring partnership-level determinations) and a partner-level component (requiring partner-level determinations). Thus, by challenging the penalty interest "as a whole," Taxpayers contend that they can avoid the statute's jurisdictional bar. We are not persuaded.

First, even assuming that penalty interest under §6221(c) is an affected item, Taxpayers only challenge a partnership-level component of this affected item (namely, the nature of the partnerships' transactions), without advancing any argument regarding partner-level components (e.g., a partner's underpayment must exceed $1,000 in order to be "substantial").[7] Second, Taxpayers' argument relies on the mistaken premise that §7422(h) only bars claims for a refund of partnership items. The statute, however, bars refund claims attributable to partnership items. Because the two terms are not coextensive, our inquiry must focus on the language in the statute. See Prochorenko, 243 F.3d at 1363 ("While it is true that the Prochorenkos were seeking a refund of partnership taxes, their refund was not 'attributable to partnership items.'").

Taxpayers also obliquely suggest that this case is tantamount to the potential situation where the IRS imposes penalty interest when no partnership-level determination has been made that the transactions were tax motivated. Quite simply, this is not that case. Each relevant FPAA disallowed the partnership's deductions because "[t]he partnership's activities constitute[d] a series of sham transactions." Taxpayers concede that the FPAAs are conclusive, as this finding was not altered by the

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[7] We, therefore, do not decide whether §7422(h) precludes jurisdiction over every claim for a refund of penalty interest imposed pursuant to §6621(c).

Settlement Agreements. And the statute is clear that a "sham or fraudulent transaction" is a "tax motivated transaction." I.R.C. §6621(c)(3)(A)(v).

More specifically, Taxpayers' argument appears to be that the relevant FPAAs fail to establish that Taxpayers' underpayments were attributable to "tax motivated transactions" because the FPAAs list multiple, independent grounds for the disallowance—some of which qualify as "tax motivated transactions" and others which do not—making it impossible to determine whether Taxpayers' underpayments were "attributable to" the tax motivated grounds. Even assuming that the Court of Federal Claims had jurisdiction over this argument, we would not be persuaded. See Irom v. Comm'r of Internal Revenue, 866 F.2d 545, 547-48 (2d Cir. 1989) (finding that taxpayer should pay penalty interest for portion of deficiency attributable to a tax motivated transaction even though that deficiency may also be attributable to other factors). The inequitable result of Taxpayers' contention would be to impose penalty interest when a deduction is disallowed because the partnerships' transactions were tax motivated, but not to impose penalty interest when that deduction is also disallowable on other inseparable grounds.

In sum, we conclude that Taxpayers' claims for a refund are barred by I.R.C. §7422(h) because they are based on the nature of the partnerships' transactions.

CONCLUSION

The Court of Federal Claims correctly determined that, under I.R.C. §7422(h), it lacked jurisdiction over: (1) Taxpayers' claims for refunds of tax and interest on the theory that the IRS assessed tax and interest after the statute of limitations in I.R.C. §6229(a) expired; and (2) Taxpayers' claims for refunds of penalty interest, I.R.C. §6621(c), on the grounds that their underpayments of tax were not attributable to "tax motivated transactions."

App. 17

AFFIRMED

In The United States Court of Federal Claims

Nos. 03-2028T & 04-907T

(Filed: April 18, 2007)

KENNETH C. KEENER, WILLIAM P. SMITH, and ANNE D. SMITH,

Plaintiffs,

v.

THE UNITED STATES,

Defendant.

* Tax refund suit; Motion
* for partial dismissal; Tax
* Equity and Fiscal
* Responsibility Act
* (TEFRA); Unified
* partnership provisions; 26
* U.S.C. §7422(h) – no
* action attributable to
* partnership item;
* Jurisdictional issue
* involving 26 U.S.C. §6229
* is either partnership item
* or affected item over
* which this court lacks
* refund jurisdiction;
* Waiver; Impact of
* individual partner
* settlements; Issue
* involving imposition of
* interest under 26 U.S.C. §
* 6621(c) is either
* partnership item or
* affected item over which
* this court lacks refund
* jurisdiction; Motion
* granted.

OPINION

Thomas E. Redding and *Teresa Jean Womack,* Redding & Associates, P.C., Houston, Texas, for plaintiffs.

Bart Duncan Jeffress, United States Department of Justice, Washington, D.C., with whom was Assistant Attorney General *Eileen J. O'Connor*, for defendant.

ALLEGRA, Judge:

In this tax suit, Kenneth C. Keener, William P. Smith and Anne D. Smith (collectively plaintiffs) seek refunds of federal income taxes and interest paid in connection with their investments in various partnerships. At issue on defendant's motion for partial dismissal of plaintiffs' complaints is whether this court has jurisdiction, notwithstanding 26 U.S.C. §7422(h), to entertain plaintiffs' claims that: (i) Notices of Final Partnership Administrative Adjustments (FPAAs) were untimely filed by the Internal Revenue Service (IRS) and cannot support the tax assessments against them; and (ii) they are entitled to recover interest charged against them for "tax-motivated transactions" pursuant to now-repealed 26 U.S.C. §6621(c).

I. BACKGROUND

In the early 1980s, American Agri-Corp, Inc. (AMCOR) organized a number of limited partnerships, for which it acted as general partner, and solicited investments from other individuals. Kenneth Keener was a limited partner in Agri Venture II (AVII) during the 1984 tax year, and a limited partner in Agri Venture Fund (AVF) during the 1985 tax year. William Smith was a limited partner in Richgrove Grape Associates (RGA) during the 1984 tax year, and a limited partner in Desert Highlands Vineyards (DVA) in the 1985 tax year. Each entity reported an ordinary loss deduction in the relevant year, which was apportioned between partners*pro rata*. The taxpayers, each filing jointly with their spouse, reported their proportionate shares of partnership losses on their 1984 and 1985 income tax returns.

In 1991, the IRS sent each of the aforementioned partnerships a FPAA, which stated that the loss deductions reported in 1984 and 1985 were not allowable because each "partnership's activities constitute[d] a series of sham transactions." Finding no allowable deductions, the agency adjusted the partnerships' reports accordingly, and assessed each of the partners their respective shares of the unpaid tax and interest. Also in 1991, several partners filed petitions for readjustment in the U.S. Tax Court, contesting the adjustments made in the FPAA. *Inter alia*, the partners claimed that the FPAA was issued after the applicable period of limitations had expired, and contested the characterization of the partnerships' activities as "sham transactions."

In 1997, while the Tax Court litigation was still pending, each of the plaintiffs and the IRS entered into settlements via Forms 870-P(AD). After accepting these settlements, the IRS assessed additional tax liability and interest pursuant to section 6621(c) of the Code.[1] Plaintiffs paid these additional amounts, and filed claims for refunds with the IRS. On July 19, 2001, the Tax Court rendered a decision in the partnership-level proceeding, finding the various partnership transactions to be sham transactions.[2] The IRS denied plaintiffs' refund claims shortly thereafter.

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[1] All references here are to the Internal Revenue Code of 1986 (26 C.F.R.), as amended, and in effect during the years at issue.

[2] Specifically, the Tax Court found that "the foregoing adjustments to partnership income and expenses are attributable to transactions which lacked economic substance, as described in former I.R.C. §6621(c)(3)(A)(v), so as to result in a substantial distortion of income and expense, as described in I.R.C. §6621(c)(3)(A)(iv), when computed under the partnership's cash receipts and disbursement method of accounting." It further found that "the assessments of any deficiencies in income tax that are attributable to the adjustments to partnership items for the years 1984 and 1985 are not barred by the provisions of I.R.C. §6629."

Thereupon, plaintiffs commenced separate refund suits in this court in 2003 and 2004, arguing: (i) that the FPAAs were issued after the applicable period of limitations had expired, rendering any amounts assessed and paid following issuance of the FPAA refundable overpayments, and (ii) alternatively, that the IRS improperly assessed penalty interest against plaintiffs because the loss deductions that they claimed were not the result of sham transactions. On August 11, 2005, these suits were consolidated.

On November 4, 2005, and August 14, 2006, defendant filed partial motions to dismiss, contesting the court's subject matter jurisdiction. On February 21, 2006, plaintiffs filed a motion for partial summary judgment, contending that the section 6621(c) penalty interest was improperly assessed because plaintiffs' transactions were not shams, or tax-motivated, transactions. Each of these motions has been fully briefed. On November 16, 2006, the court conducted oral argument, but restricted the discussion to issues involving its subject matter jurisdiction.

II. DISCUSSION

Before embarking into the wilds of the TEFRA partnership provisions, one is welladvised to review the contours of the terrain.

A. Statutory Background

"Although they file information returns under section 701 of the Code," this court has observed, "partnerships, as such, are not subject to federal income taxes. Instead, under section 702 of the Code, they are conduit entities, such that items of partnership income, deductions, credits, and losses are allocated among the partners for inclusion in their respective returns." *Grapevine Imports Ltd. v. United States*, 71 Fed. Cl. 324, 326 (2006); *see also United States v. Basye* , 410 U.S. 441, 448 (1973). Prior to 1983, the examination of a partnership for federal tax purposes was

a tedious affair, essentially encompassing an audit of each partner. The limitations period for making assessments was determined at the partner level and, because any resulting litigation was also conducted at that level, multiple proceedings in different venues involving the same partnership were common, sometimes producing a welter of inconsistent results. *See* Arthur B. Willis, John S. Pennell & Philip F. Postlewaite, Partnership Taxation (hereinafter "Pennell") at ¶ 20.01[2] (6th ed. 1999) (describing the pre-1983 procedures); *Grapevine Imports*, 71 Fed. Cl. at 326-27.

Seeking to remedy this sitution, Congress revolutionized the scheme for auditing partnerships in the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, 648-671 (TEFRA). TEFRA "created a single unified procedure for determining the tax treatment of all partnership items at the partnership level, rather than separately at the partner level." *In re Crowell*, 305 F.3d 474, 478 (6 Cir. 2002) (citing th H.R. Conf. Rep. No. 97-760, at 599-600 (1982)). Under this new regime, partnerships are required to file informational returns reflecting the distributive shares of income, gains, deductions, and credits attributable to their partners, while individual partners are responsible for reporting their *pro rata* share of tax on their income tax returns. *See* 26 U.S.C. §701; *Weiner v. United States*, 389 F.3d 152, 154 (5th Cir. 2004), *cert. denied*, 544 U.S. 1050 (2005); *Kaplan v. United States*, 133 F.3d 469, 471 (7th Cir. 1998).

The threshold determination whether, *vel non*, an item is a "partnership item" governs how the TEFRA procedures apply. The treatment of partnership items is resolved at the partnership level, in a unified partnership proceeding. 26 U.S.C. §6221; *see also id.* at §§6211(c), 6230(a)(1). While TEFRA defines a "partnership item" in various ways, the concept generally encompasses items "required to be taken into account for the partnership's taxable year" and those "more appropriately determined at the partnership level

than at the partner level." *Id.* at §6231(a)(3).[3] Which items are "more appropriately determined at the partnership level" is further refined in Treasury Regulation section 301.6231(a)(3)-1(a), which provides that such items include the income, gains, losses, deductions and credits of a partnership. *See also Prochorenko v. United States* , 243 F.3d 1359, 1363 (Fed. Cir. 2001). In addition, Treasury Regulation section 301.6231(a)(3)-1(b) states –

> The term "partnership item" includes the accounting practices and the legal and factual determinations that underlie the determination of the amount, timing and characterization of items of income, credit, gain, loss, deduction, etc.

Nonpartnership items are those items that are not partnership items, 26 U.S.C. §6231(a)(4), the tax treatment of which is resolved at the individual partner level, using, *inter alia*, the normal deficiency procedures of the Code. *Id.* at §§6211, 6212, 6230(a)(2); *see Crnkovich v. United States*, 202 F.3d 1325, 1328-29 (Fed. Cir. 2000) (per curiam). At the interstices between partnership and nonpartnership items lies a third category of TEFRA items, so-called "affected items," hybrids of a sort, defined as "any item to the extent

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[3] In relevant part, section 6231(a)(3) states –

> (3) Partnership item. – The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

26 U.S.C. §6231(a)(3).

such item is affected by a partnership item." 26 U.S.C. §6231(a)(5).[4]

If the IRS decides to adjust any "partnership items" reflected on the partnership's return, it must notify the individual partners of the adjustment through a FPAA. 26 U.S.C. §6223; *Kaplan*, 133 F.3d at 471. The period for making assessments under TEFRA is, with exceptions not pertinent herein, the cross-product of two vectors corresponding to sections 6229(a) and 6501 of the Code. The former provides generally that –

> the period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year shall not expire before the date which is 3 years after the later of – (1) the date on which the partnership return for such taxable year was filed, or (2) the last day for filing such return for such year (determined without regard to extensions).

Section 6501(a) of the Code provides in pertinent part: "Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed . . . ." Contrary to plaintiffs' claims herein, the Federal Circuit recently held that section 6229(a) of the Code unambiguously extends the statute of limitations in section 6501 of the Code for assessing taxes on partnership items. *AD Global, LLC ex rel. North Hills Holding, Inc. v. United States*, 2007 WL 624366 at *2 (Fed. Cir. March 2, 2007). In that case, the court opined that "[section] 6229(a) does not provide a separate statute of

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[4] Penalties assessed against a partner based on the partner's tax treatment of partnership items on his individual return are examples of such "affected items." *See Olson v. United States*, 172 F.3d 1311, 1316-17 (Fed. Cir. 1999).

limitations, but simply creates a minimum period that may extend the regular statute of limitations for partnership items." *Id.* at *1; *see also Crnkovich*, 202 F.3d at 1335 n.7; *Grapevine*, 71 Fed. Cl. at 339.[5]

For ninety days following issuance of an FPAA, the tax matters partner (TMP) has the exclusive right to file a petition for readjustment of the partnership items in the Tax Court, this court, or a United States District Court. 26 U.S.C. §6226(a); *see also Monahan v. Comm'r of Internal Revenue*, 321 F.3d 1063, 1065 (11th Cir. 2003). Thereafter, certain other partners with significant holdings in the partnership have sixty days to file a petition for readjustment. 26 U.S.C. §6226(b)(1). If a partner's tax liability might be affected by the outcome of the litigation of partnership items, that partner may participate fully in the proceeding. *Id.* at §§6224(a), 6224(c). The IRS may assess

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[5] Outlining how its ruling comports with the TEFRA statutory scheme, the Federal Circuit explained –

> TEFRA generally requires determination of the tax treatment of partnership items at the partnership level. In the partnership-level administrative proceeding, the IRS may adjust items reported on the partnership tax return which, in turn, would affect the corresponding items on the income tax returns of the individual partners. Each partner receives notice of the beginning of such an administrative proceeding, may participate in the proceeding, and receives notice of the FPAA. This scheme contemplates that adjustments to partnership items are made in one proceeding before assessments are made at the individual partner level. Our interpretation may extend the regular statute of limitations in §6501(a) for assessments to individual partners, but does not alter the statutory scheme of determining partnership items in one partnership-level proceeding.

AD Global, 2007 WL 624366 at *3 (citations omitted). The court thus concluded that its construction of section 6229(a) "is consistent with a statutory scheme that intends that adjustment to a partnership tax return be completed in one consistent proceeding before individual partners are assessed for partnership items." *Id.*

additional tax liability against individual partners within one year of the final conclusion of the partnership's tax determination. *Id.* at §6229(d). In theory, the partner may contest the tax liability by paying the assessment and filing a refund action in this court. However, with exceptions not relevant herein, "[n]o action may be brought [in this court] for a refund attributable to partnership items (as defined in section 6231(a)(3))." *Id.* at §7422(h); *see also Prochorenko*, 243 F.3d at 1362-63.

To the extent a partner settles his partnership tax liability with the IRS, the partner no longer participates in the partnership level litigation, and instead is bound by the terms of the settlement agreement. 26 U.S.C. §§6224(c)(1), 6226(d), 6228(a)(4)(B). Partnership items convert to nonpartnership items when the IRS enters into a settlement agreement with the partner with respect to such items. *Id.* at §6231(b)(1)(C). If a partner files an action for a refund attributable to partnership items, but those items have been converted through a settlement agreement, the jurisdictional bar of §7422(h) no longer applies. *See Alexander v. United States*, 44 F.3d 328, 331 (5th Cir. 1995).

With this brief *tour d'horizon*, the court now turns to the twin jurisdictional dilemmas posed by defendant's first dismissal motion.

B. FPAA Limitations Period

Plaintiffs chiefly base their refund claims on the theory that their respective individual statutes of limitations on assessments had run prior to the time the IRS assessed income taxes and interest against them in 1998 and 2001, respectively. To avoid the jurisdictional bar of 26 U.S.C. §7422(h), they argue that whether section 6229(a) extended their individual limitations periods on assessment found in section 6501 of the Code is not a "partnership item." In so contending, they stress that the specific timing of the assessment periods under section 6501 is unique to each

partner, claiming, as a result, that the assessment periods here are "affected items" that the Tax Court could not have reached in the partnership-level case. Because these issues were not before the Tax Court, they maintain, they could not have been encompassed within the section 6224(c) partnership item settlements. The result, according to plaintiffs, is that the limitations issue may be raised here. Not so, defendant contends. It asserts that plaintiffs may not raise their statute of limitations defense for the first time here, having failed to pursue it at the earlier partnership-level proceeding.

Plaintiffs' argument hinges on several faulty premises, which the court will examine in detail. The first of these is that the limitations issue presented involves either an affected item, or perhaps a nonpartnership item that ***can*** be resolved here. In fact, as will be seen, the converse is true – the limitations issue involves either a partnership item or an affected item that ***cannot*** be resolved here.

In a well-rehearsed claim, plaintiffs assert that the issues presented do not constitute a partnership item because the provisions at issue, sections 6229(a) and 6501 of the Code, lie in subtitle F of title 26. They note that section 6231(a)(3) defines a partnership item as any item required to be taken into account for the partnership's taxable year "under any provision of subtitle A." But, the latter reference does not, in so many words, prevent a court from treating, as partnership items, legal issues that impact whether the Commissioner's treatment of partnership items arising under subtitle A will be sustained. Indeed, the relevant Treasury Regulation defines a "partnership item" as including "the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit gain, loss, deduction, etc." Treas. Reg. §301.6231(a)(3)-1(b). Reflecting the breadth of this definition, issues concerning section 6229 have been held to

involve an underlying legal determination within the meaning of this regulation and thus have been treated as partnership items. *See Weiner*, 389 F.3d at 157; *Slovacek*, 36 Fed. Cl. at 255. Other cases, often citing the above legislative regulation, repeatedly have held that the presence of various provisions in subtitle F does not prevent them from being considered partnership items. Some of these cases deal with the assessment provisions in subtitle F, *see, e.g.*, *River City Ranches #1 Ltd. v. Comm'r of Internal Revenue*, 401 F.3d 1136, 1144 (9th Cir. 2005); while others deal with subtitle F provisions that involve the conduct or authority of the TMP, *see Kaplan*, 133 F.3d at 473; *Clark*, 68 F. Supp. 2d at 1345; *Klein v. United States*, 86 F. Supp. 2d 690, 696 (E.D. Mich. 1999). Based on these various decisions, as well as the statutory and regulatory provisions upon which they are based, it would appear that to the extent this case requires a construction of section 6229(a), it involves a partnership item, preventing those arguments from being considered here. *See Weiner*, 398 F.3d at 156 (rejecting the notion that the placement of section 6229(a) in subtitle F is controlling).

One, of course, might reasonably argue that issues involving the interaction of sections 6229 and 6501 are instead "affected items" – parsing the definition under section 6231(a)(5), this interaction could be viewed as giving rise to an item (the section 6501 limitations) "affected by a partnership item" (the 6229(a) extension). *See* Treas. Reg. §301.6231(a)(5)-1(a). But, even if true, that does not mean that this court has jurisdiction over this issue. Under the TEFRA partnership rules, affected items essentially have two prongs – one involves a partnership issue, while the second involves a nonpartnership issue, with the latter affecting the former. *See* Pennell, *supra*, at ¶20.02[4][c]. It is well-established that the partnership prong of an affected item – in this case, the proper construction of section 6229(a) – must be determined first in a unified partnership proceeding. The result from that proceeding is then applied

at the individual partner level to the extent that it impacts what otherwise is a nonpartnership item – in this case, the limitations period on assessments. As the Tax Court has repeatedly explained, "because the tax treatment of an 'affected item' depends upon the partnership-level determination, affected items generally cannot be tried as part of a partner's tax case prior to the completion of the partnership-level proceeding'" *GAF Corp. & Subs . v. Comm'r of Internal Revenue* , 114 T.C. 519, 528 (2000) (quoting *Gillilan v. Comm'r of Internal Revenue*, 66 T.C.M. (CCH) 398, 401 (1993)); *see also Katz v. Comm'r of Internal Revenue*, 335 F.3d 1121, 1124 (10th Cir. 2003); *Dubin v. Comm'r of Internal Revenue*, 99 T.C. 325, 328 (1992); *Clark*, 68 F. Supp. 2d at 1347; *Maxwell v. Comm'r of Internal Revenue*, 87 T.C. 783, 792-93 (1986).[6] These cases hold that partners must first raise any partnership item that "affects" their personal items at the partnership level proceeding – they must, in other words, obtain resolution of the partnership prong of their affected items before later turning to the affected nonpartnership prong.

But, what if they do not? What if, for example, the partnership item is not resolved in the partnership-level proceeding or the partner no longer is a party to that proceeding when the issue is resolved? In such circumstances, the structure of the TEFRA partnership provisions seemingly dictates that a court may not, in a partner-level proceeding, consider a challenge to the

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[6] Other cases are not to the contrary. For example, while several cases talk in terms of penalties being affected items addressed at the individual partner level, *Monahan*, 321 F.3d at 1066, these cases involve situations in which the partnership items affecting the penalties had already been resolved at the partnership level. *See, e.g., Callaway v. Comm'r of Internal Revenue*, 231 F.3d 106, 110 (2d Cir. 2000); *see also Chimblo v. Comm'r of Internal Revenue*, 177 F.3d 119, 121 (2d Cir. 1999), *cert. denied*, 528 U.S. 1154 (2000); *Olson v. United States*, 37 Fed. Cl. 727, 733 (1997), *aff'd*, 172 F.3d 1311 (Fed. Cir. 1999).

partnership prong of an affected item, thus effectively precluding such a court from considering the affected item at all. Certainly, the TEFRA provisions authorize the individual partner to pursue, in the partnership proceeding, the resolution of any partnership issues that might impact his affected items. In this regard, section 6226(c) of the Code entitles a partner to participate fully as a party in the partnership proceeding, presumably allowing such a partner to raise issues that are not raised by the TMP. *See Clark* , 68 F. Supp. 2d at 1345-46 (discussing this provision).[7] Such partners also may generally opt out of any settlements reached by the TMP, should they so choose. *See* 26 U.S.C. §6224(c). Moreover, while, under section 6226(d) of the Code, a partner forfeits this right to participate in the unified partnership proceeding if he settles all of his partnership items, such is apparently not the case if a partial settlement leaves extant one or more partnership items that impact an affected item. Tying these provisions together, section 6229(a) expressly extends the statute of limitations for "affected items" undoubtedly to ensure that this process can run its course. *See AD Global*, 2007 WL 624366 at *3; Pennell, *supra*, at ¶20.02[5]. It is implicit in this structure that if the partner chooses not to pursue his rights in the unified partnership proceeding, he may not

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[7] In this regard, one group of commentators has stated t 7 hat "[n]o matter who files the petition for readjustment of partnership items for a taxable year, every person who was a partner in the partnership at any time during the taxable year involved and who has an interest in the outcome of the action is a party to the action," adding that "[t]he court having jurisdiction of the action must allow the person to participate in the action." Pennell, *supra*, at ¶20.06[2]. Consistent with the statute, such partners are considered full parties in the partnership-level proceedings under both the TEFRA partnership procedural rules adopted by the Tax Court and this court. *See* RUSTC 245, 247; RCFC, Appendix F, paras. 4, 6. It should be noted that if the TMP does not file a petition to initiate the partnership-level proceeding, the partner may file such a petition. 26 U.S.C. §6226(b)(1).

later challenge the partnership prong of his affected item in a subsequent partner-level proceeding. And the cases so hold. *See GAF Corp.*, 114 T.C. at 526-27; *Lindsey v. Comm'r of Internal Revenue*, 84 T.C.M. 521, 522 (2002) (finding no jurisdiction, noting "[p]etitioners had an opportunity to raise their allegation during the TEFRA procedures, but they failed to do so"). Indeed, a contrary holding would threaten "the line of demarcation drawn by Congress between the audit and litigation of partnership tax matters and the resolution of all other tax items of the partner." *Carmel v. Comm'r of Internal Revenue*, 98 T.C. 265, 269 (1992).

Whether the court views the interaction of sections 6229(a) and 6501 as involving a partnership item or as an affected item, the result is the same – the court is precluded from considering the statute of limitations issue plaintiffs raise in this partner-level proceeding. This conclusion proceeds from two distinct rationales. First, in terms of the Code, any resulting refund here would be "attributable to" partnership items within the meaning of section 7422(h), at least as the quoted language in that provision is ordinarily understood. *See Braunstein v. Comm'r of Internal Revenue*, 374 U.S. 65, 70 (1963) ("attributable" means "caused or generated by"); *Gilman v. Comm'r of Internal Revenue*, 933 F.2d 143, 151 (2d Cir. 1991), *cert. denied*, 502 U.S. 1031 (1992) ("attributable" means "stems from"); *see also* The Am. Heritage Dictionary of English Language 117 (4th ed. 2000).[8] Consistent with this view, it would appear that

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[8] In *Monti v. United States*, 223 F.3d 76 (2d 8 Cir. 2000), the Second Circuit held that a non-settling partner's claim for tax treatment consistent with that accorded other partners in a settlement with the IRS was not a claim for refund attributable to a "partnership item." In so concluding, the court rejected an interpretation of the "attributable to" language that would have swept into partnership proceedings claims "entirely about and entirely dependent on facts peculiar to a single partner." *Id.* at 82. Here, of course, resolution of the limitations issue is

section 7422(h) precludes the court from considering, in partner-level proceedings, not only partnership items standing alone, but also partnership items that impact affected items otherwise before the court, such partnership items being what the court has termed the "partnership prong" of the affected item. Construing the statute in this fashion has the added value of effectuating, rather than defeating, the twin purposes of section 7422(h) – to promote judicial economy and consistency of decision. It avoids the prospect of courts wasting considerable resources deciding substantive tax issues in unified partnership proceedings, only to find out later that no assessments can be made. And it averts the welter of conflicting decisions that might result should each partner, in pursuing affected items, be allowed litigate in an individual refund action issues common to the partnership as a whole partnership.[9]

Second, wholly apart from section 7422(h), it appears that plaintiffs have waived their limitations objection. As others of their colleagues apparently did, they could have pursued their statute of limitations defense in the earlier partnership-level proceeding, but, apparently in the interest

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not entirely dependent upon facts peculiar to plaintiffs; indeed, the arguments made by plaintiffs are common to any partners from whom the section 6501 assessment period assertedly had run. Other cases have distinguished *Monti* on this basis. *See Weiner*, 389 F.3d at 157-58.

[9] If plaintiffs were correct virtually any partnership item could be indirectly considered in a partner-level proceeding. To give but one more example, section 213(a) determines the allowability of medical expenses as a function of the individual's adjusted gross income, which, of course, would depend upon the partnership distributive share of the partnership income or loss. A case concerning such a medical expense deduction should not provide a vehicle for consideration of the partnership's income or losses. *See Callaway*, 231 F.3d at 110 n.4.

of obtaining a favorable settlement, chose not to do so.[10] In such circumstances, the jurisprudence of both the Tax Court and this court suggest that the limitations argument they now raise is not jurisdictional, but rather was an affirmative defense that, by their actions, was waived. *See, e.g.*, *United States v. Hitachi America, Ltd.*, 172 F.3d 1319, 1333-34 (Fed. Cir. 1999); *Columbia Bldg., Ltd. v. Comm'r of Internal Revenue*, 98 T.C. 607, 611-12 (1992); *cf. John R. Sand & Gravel Co. v. United States*, 457 F.3d 1345, 1354 (Fed. Cir. 2006) (statute of limitations in 28 U.S.C. §2501 is jurisdictional and not waived). Nor are plaintiffs correct in asserting that such a waiver should not apply here because the courts have refused to consider arguments concerning section 6229(a) in unified partnership proceedings. In fact, arguments concerning that section were raised in the very partnership proceeding in which plaintiffs initially participated. *Agri-Cal Venture Assocs. v. Comm'r of Internal Revenue*, 80 T.C.M. (CCH) 295, 297 (2000). And similar issues concerning the impact of section 6229 on assessment periods have been resolved in a variety of partnership-level proceedings under section 6226(f) of the Code, most recently in the Federal Circuit's decision in *AD Global*, 2007 WL 624366 at *1-2.[11] Accordingly, plaintiffs should not now be heard to raise limitations objections that they could have pressed – and that others, indeed, pressed – in the unified partnership proceeding.

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[10] Plaintiffs certainly could have raised this issue even if it was not raised by other partners. In this regard, section 6226(c) of the Code indicates that in partnership-level proceedings: "(1) each person who was a partner in such partnership at any time during such year shall be treated as a party to such action, and (2) the court having jurisdiction of such action shall allow each such person to participate in the action."

[11] *See also, e.g.*, *Grapevine Imports*, 71 Fed. Cl. at 328-29; *Rhone-Poulenc Surfactants & Specialties, L.P. v. Comm'r of Internal Revenue*, 114 T.C. 533, 535 (2000), *appeal dismissed and remanded*, 249 F.3d 175 (3d Cir. 2001).

This court is not the first to reach these conclusions. Far from it. In *Chimblo*, 177 F.3d at 125, the taxpayer also argued that the individual limitations period in section 6501 had expired prior to the time the IRS issued the relevant FPAA notices. The Second Circuit, however, noted that such a statute of limitations defense is not jurisdictional and could be waived if not raised at the appropriate time. *Id.* Finding further that issues concerning the construction of section 6229 were partnership items, the court noted that "[i]n the context of this case, one involving the application of TEFRA, petitioners had a right to raise the partnership statute of limitations defense in the earlier partnership-level proceeding, but failed to do so." *Id.* The Second Circuit concluded that a statute of limitations defense concerns a "partnership item . . . that must be raised at the partnership level." *Id.* "Allowing individual taxpayers to raise a statute of limitations defense in multiple partner-level proceedings," the court observed, "would undermine TEFRA's dual goals of centralizing the treatment of partnership items and ensuring the equal treatment of partners." *Id.*

A legion of decisions are to similar effect, proceeding either on the basis that section 6229(a) involves a partnership item or that the failure to raise that section in a partnership-level proceeding resulted in a waiver. *See Weiner*, 389 F.3d at 156-57 ("the majority of courts to consider this issue have held that the FPAA statute of limitations issue is a partnership item that must be litigated in a partnership level proceeding"); *Davenport Recycling Assocs. v. Comm'r of Internal Revenue*, 220 F.3d 1255, 1260 (11th Cir. 2000) ("taxpayers must raise the statute of limitations defense within the context of a partnership-level proceeding"); *Williams v. United States*, 165 F.3d 30 (6th Cir. 1998) (Table), 1998 WL 537579, at *3 ("It is well established that [FPAA] statute of limitations challenges are considered challenges to a partnership item."); *Kaplan v. United States*, 133 F.3d 469, 473 (7th Cir.

1998) ("this kind of statute of limitation challenge concerns a partnership item"); *Crowell v. Comm'r of Internal Revenue*, 102 T.C. 683, 693 (1994) ("[w]e conclude that the statute of limitations defense as it pertains to the FPAA . . . should have been prosecuted within the context of a partnership level proceeding and is not properly before us in this proceeding"). [12] Although these decisions employ different rationales, they uniformly "have reasoned that because the FPAA limitation issue affects the partnership as a whole, it should not be litigated in an individual partner proceeding, as such a result would contravene the purposes of TEFRA." *Weiner*, 389 F.3d at 156-57. And this court sees no reason to disagree.

Plaintiffs' settlement agreements with the IRS do not render the above cases inapposite. To be sure, as in effect during the years in question, section 6231(b)(1)(C) of the Code converted partnership items into nonpartnership items when "the Secretary enters into a settlement agreement with the partner with respect to such items." Thus, by virtue of a settlement agreement, items previously viewed as partnership items can become individualized, arguably rendering the constraints imposed by section 7422(h) inapplicable. *See Slovacek v. United States*, 40 Fed. Cl. 828, 829-30 (1998); *Olson*, 37 Fed. Cl. at 733. Plaintiffs assert that such a metamorphosis happened here, but with a novel and convenient twist – while they contend that the agreements were sufficient to convert the limitations issue into a nonpartnership item, they assert that the agreements did not resolve the limitations issue, leaving them free to litigate that issue here. If plaintiffs are right, their agreements put them in a truly enviable position – what might be described as "heads we win, tails we win bigger"

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[12] *See also Clark*, 68 F. Supp. 2d 12 at 1344; *Thomas v. United States*, 967 F. Supp. 505, 506 (N.D. Ga. 1997); *Barnes v. United States*, 1997 WL 732594, at *3 (M.D. Fla. 1997), *aff'd*, 158 F.3d 587 (11th Cir. 1998).

– that is, if the limitations provision did not bar the assessments here, the agreements limit plaintiffs' tax liability, but if the limitations provision barred the assessments, plaintiffs owe nothing.

While the field of federal taxation is marked by several "*Helvering*" doctrines such as "substance over form," there is, strictly speaking, no "too good to be true" rule. Yet, that is no cause for this court blithely to embrace an absurd result – or to conclude that the IRS or the Congress did so. In terms of the IRS, two provisions in the settlement agreements at issue suggest that any objections concerning the timeliness of the assessments were waived by plaintiffs in exchange for benefits received from the IRS. The agreements thus provide that the taxpayer "offers to waive the restrictions on the assessment and collection of any deficiency attributable to partnership items" and that "no claim for refund or credit based on any change in the treatment of partnership items may be filed or prosecuted." In the court's view, the most reasonable reading of these provisions – indeed, the only interpretation that would not render them virtually meaningless – is that plaintiffs, in exchange for being allowed to deduct some of the losses associated with their investments, agreed not to challenge the validity of any assessments resulting from the specified treatment of the partnership items. *See Slovacek v. United States*, 36 Fed. Cl. 250, 256 (1996) (agreeing that the plaintiffs waived "their right to rely on the supposed invalidity of the partnership's waiver of the statute of limitations in executing the Form 870-L(AD)"); *see also Olson v. United States*, 172 F.3d at 1318.[13] Accordingly, far

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[13] It is, of course, axiomatic that an interpretation of an agreement "which gives a reasonable meaning to all parts will be preferred to one which . . . achieves a weird and whimsical result." *Arizona v. United States*, 575 F.2d 855, 863 (Ct. Cl. 1978); *see also Fortec Constr. v. United States*, 760 F.2d 1288, 1292 (Fed. Cir. 1985); *Franconia Assocs v. United States*, 61 Fed. Cl. 718, 730 (2004).

from aiding plaintiffs, if anything, these settlement agreements suggest yet another reason why this court should not consider plaintiffs' limitations argument.[14]

Assuming, *arguendo*, that the agreements did not settle the limitations issue *sub judice*, then it would seem to follow that they were ineffective to convert that issue into a nonpartnership item for purposes of section 7422(h). Upon close reading, the language of section 6231(b)(1)(C) plainly applies on an item-by-item basis, as it states that the partnership items of a partner shall become nonpartnership items as of the date the Secretary enters into a settlement agreement with the partner with respect to "such items." The last phrase, of course, would be superfluous if, as plaintiffs intimate, the entry of a settlement agreement as to ***any*** partnership item converts ***every*** partnership item into a nonpartnership item. That the phrase "such items" refers only to those items actually covered by an agreement is confirmed by several other subparagraphs in section 6231(b)(1) that employ the same phraseology. One of these, section 6231(b)(1)(A), provides that partnership items shall become nonpartnership items as of the date the Secretary mails to such partner a notice that "such items" shall be treated as nonpartnership items. Modifying this provision, section 6231(b)(2)(B)(i) of the Code states that this notice may be provided as to "one or more of such [partnership] items." Because "such items," as used in the notice provision of section 6231(b)(1)(A), obviously connotes that less than all the available partnership items need be converted, it is reasonable to assume that the same holds true in section 6231(b)(1)(C), that is, that only those

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[14] Although plaintiffs do not raise this issue, it should be noted that even if the settlement agreements were not binding of their own force, they became so under principles of equitable estoppel once the IRS could not recoup the benefits conferred upon plaintiffs. *See Union Pacific R. Co. v. United States*, 847 F.2d 1567, 1571-73 (Fed. Cir. 1988).

partnership items actually resolved in a settlement agreement are converted to nonpartnership status.[15] *See Weiner*, 389 F.3d at 156 n.2 ("The Code provides that only those partnership items encompassed by the settlement agreement are converted to nonpartnership items."). This view is also consistent with the statute's legislative history, which, though limited on this point, plainly suggests that section 6231's conversion of partnership to nonpartnership items can occur selectively.[16]

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[15] Another common rule of construction holds that identical words in different parts of the same statute are presumed to have the same meaning. *Helvering v. Stockholms Enskilda Bank* , 293 U.S. 84, 88-89 (1934); *Murakami v. United States*, 52 Fed. Cl. 232, 241 (2002).

[16] *See* H.R. Conf. Rep. 97-16 760 at 609 (discussing the notice provision and stating that "[t]he Secretary may notify a partner that *a* partnership item will be treated as *a* nonpartnership item") (emphasis added); *id.* at 611 ("Neither the Secretary nor the taxpayer will be permitted to raise nonpartnership items in the course of a partnership proceeding nor may partnership items, except to the extent they become nonpartnership items under the rules, be raised in proceedings relating to nonpartnership items of a partner."). In 1997, Congress modified sections 6229(f)(1) and 6601(c) to deal specifically with situations in which the IRS and a taxpayer entered into a settlement agreement with respect to some, but not all, of the partnership items in dispute for a partnership taxable year. While this provision is ineffective for the years in question, it is notable that, in the 1992 legislative history, Congress clearly thought that current law, dating back to the original TEFRA, anticipated that settlement agreements could be entered into covering some, but not all, partnership items. Thus, in explaining the reason for passing the provision, the accompanying House Report states that –

> [w]hen a partial settlement agreement is entered into, the assessment period for the items covered by the agreement may be different than the assessment period for the remaining items. This fractured statute of limitations poses a significant tracking problem for the IRS and necessitates multiple computations of tax with respect to each partner's investment in the partnership for the taxable year.

H.R. Rep. No. 102-631, at 145 (1992); *see also* H.R. Rep. No. 105-148, at

Contrary to plaintiffs' claims, the court sees nothing in the regulations that existed prior to 1997 to indicate that section 6224(c) settlements had to be comprehensive. Plaintiffs make the latter claim in asserting that the agreements in question necessarily had to convert plaintiffs' limitation periods to nonpartnership items. But, plaintiffs err in suggesting that any such comprehensiveness was dictated by Treas. Reg. §301.6224(c)-3T(b) (1987), which states that "[s]ettlements shall be comprehensive, that is a settlement may not be limited to selected items." A careful review reveals that this regulation had nothing to do with the scope of all TEFRA settlements, but rather was designed only to implement the requirement under section 6224(c) of the Code that if the IRS enters into a settlement agreement with any partner, it shall offer any other partner who so requests settlement terms consistent with those contained in the first settlement agreement. Placed in its proper context, it is readily apparent that not every TEFRA settlement had to be "comprehensive" under this regulation, but rather only those subsidiary agreements entered into based upon the consistency requirement – in other words, the regulation sensibly indicates that to obtain a consistent settlement, the second partner seeking to settle must agree to all the terms that were in the original settlement. [17] Moreover, even if plaintiffs' interpretation were correct – requiring the court to conclude that the Treasury imposed a requirement of comprehensiveness found nowhere in the

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591 (1997).

[17] The latter point, indeed, was made explicit in 17 temporary regulations issued in 1999. *See* Treas. Reg. §301.6224(c)-3T(b) (2001), 64 Fed. Reg. 3837, 3838 (Jan. 26, 1999) ("A consistent settlement agreement must mirror the original settlement and may not be limited to selected items from the original settlement."). This requirement seems logical, as the give- and take that occurs in resolving multiple items via settlement seemingly would preclude a partner from picking and choosing among settlement terms.

statute – it is difficult to see how that assists them. If the limitations period was resolved by the agreement, plaintiffs cannot raise it here; if it was not resolved by the agreement, the issue was resolved by the prior litigation, in which the Tax Court explicitly ruled that section 6229 extended the statute of limitations on assessment. Nothing in these regulations suggests that Congress intended that a settlement could be both ineffective to resolve the treatment of an issue and yet convert that same issue into a nonpartnership item that could then be raised, at the partner's choosing, in an individual refund suit.[18]

In sum, the settlement agreements here may well present an additional basis for rejecting plaintiffs' claims, they certainly provide no escape path from the refund suit limits imposed by section 7422(h). Those statutory restrictions require the court to dismiss plaintiffs'

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[18] In rejecting a similar claim, the Fifth Circuit recognized that adopting the taxpayer's position would undercut Congress' intent in enacting TEFRA, stating in *Weiner* –

> From a practical perspective, a finding of jurisdiction over the statute of limitations issue would create an absurd result that contravenes TEFRA. As was the case here, partners could settle with the IRS and thus eliminate their ability to participate in and be bound by the result of any partnership-level proceeding. But if, as here, the Tax Court decided the substantive statute of limitations issue against the partnership, the settling partners could simply bring individual partner- evel suits in the district courts and attempt to obtain a different ruling on the statute of limitations issue. Thus, some partners would be required to pay the assessed deficiency, while others would not. The result advocated by the taxpayers here is at odds with TEFRA's goal of consolidating decisions that affect the partnership as a whole.

389 F.3d at 158. In fact, even if plaintiffs could convince the court that this result was intended, it remains that section 6231(b)(1)(C) only talks of partnership items and says nothing about converting "affected items" into nonpartnership items, arguably leaving the partnership prong of such items to be resolved in partnership-level proceedings.

complaints to the extent they raise the sections 6229/6501 limitations issue.

C. Penalty Interest

Defendant next asserts that this court lacks jurisdiction, under section 7422(h), to consider plaintiffs' claim that the IRS erred in asserting interest against them under former 26 U.S.C. §6621(c). Between 1984 and 1989, the latter section provided for an increased rate of interest on substantial underpayments of tax attributable to "tax-motivated transactions."[19] In relevant part, subsection (c)(3) thereof defined "tax motivated transactions" as "any loss disallowed by reason of section 465(a)" and "any sham or fraudulent transaction." 26 U.S.C. §§ 6621(c)(3)(ii), (v). In fact, the IRS invoked both of the latter prongs in assessing interest here. Before analyzing this issue under TEFRA, it is appropriate to outline what is involved, in terms of proof, in disallowing losses under section 465(a) of the Code and the sham transaction doctrine, respectively.

Section 465(a)(1) operates as a limitation on the loss deductions allowed by other provisions of the Code, stating that "any loss" from an activity covered by the section "shall be allowed only to the extent . . . the taxpayer is at risk." To the extent pertinent here, a "taxpayer" is considered to be at risk for the amount of cash contributed and for certain

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[19] Upon enactment in 1984, this provision was codified as 26 U.S.C. §6621(d). It was amended and redesignated as 26 U.S.C. §6621(c) by the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2744, §§1511(c)(1)(A)-(C). Section 6621(c) applies to interest accruing after December 31, 1984, even if the transaction was entered into before the date of its enactment. Tax Reform Act of 1984, §144(c), Pub. L. No. 98-369, Div. A, July 18, 1984, 98 Stat. 494 (1984). This subsection was among several penalty provisions replaced with a single "accuracy-related" penalty by the 1989 Act. *See* H.R. Rep. No. 101-247, at 1388-94 (1989). Despite its repeal, section 6621(c) remains applicable to tax years prior to 1989.

amounts borrowed for the activity. 26 U.S.C. §465(b). Furthermore, a "taxpayer" generally is not at risk for "amounts protected against loss through nonrecourse financing, guarantees, stop loss agreements, or other similar arrangements." *Id.* at §465(b)(4).[20] The decisional law is quite clear that, in the case of a partnership, the "taxpayer" to whom these "at-risk" rules apply is the individual partner. Indeed, it would be difficult to envision otherwise, particularly since partnerships themselves do not qualify as taxpayers for purposes of the Code. Nonetheless, courts applying the "at risk" provisions must often consider not only what the partner contributed to the partnership, but the nature of the obligations flowing among the partner, the partnership, and, at times, third-parties. Reflecting this, several cases directly involving the "at risk" provisions have concluded that their application is not a "nonpartnership item," but rather an affected item. *See, e.g., Ginsburg v. Comm'r of Internal Revenue*, 127 T.C. 75, 92-83 (2006); *Greenberg Bros. P'ship #4 v. Comm'r of Internal Revenue* , 111 T.C. 198, 202 (1998); *Hambrose Leasing 1984-5 Ltd. P'ship v. Comm'r of Internal Revenue*, 99 T.C. 298, 312-13 (1993); *Roberts v. Comm'r of Internal Revenue*, 94 T.C. 853, 861 (1990).[21] Under this view, issues involving items such as the nonrecourse character of partnership notes or the economic substance of partnership

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[20] Section 465 was added to the Code in 1976 to combat abuse of tax shelters caused by nonrecourse financing, and other situations in which taxpayers were effectively immunized from any realistic possibility of suffering. *See* S. Rep. No. 94-938, at 47-49 (1976); *see also Comm'r of Internal Revenue v. Tufts*, 461 U.S. 300, 309 n.7 (1983); *Pritchett v. Comm'r of Internal Revenue*, 827 F.2d 644, 646 (9th Cir. 1987).

[21] The Treasury Regulations under section 6231 leave this issue somewhat unresolved in stating that "[t]he application of the at-risk limitation under section 465 to a partner with respect to a loss incurred by a partnership is an affected item to the extent that it is not a partnership item." Treas. Reg. §301.6231(a)(5)-1(c).

transactions are to be resolved in a partnership-level proceeding, with those determinations then being binding on the partners in any refund litigation that would ensue. *See Greenberg Bros. P'ship* , 111 T.C. at 202 ("there are partnership item components to the at risk calculation that affect that determination at the partner level"); *Hambrose Leasing*, 99 T.C. at 312.

The situation is slightly different for transactions found to be tax-motivated because they are shams. There are two predominant "tests" for identifying such shams. The Fourth Circuit has adopted a two-prong standard for disregarding a transaction under the so-called "sham transaction doctrine," stating that "[t]o treat a transaction as a sham, the court must find that the taxpayer was motivated by no business purposes other than obtaining tax benefits . . . and that the transaction has no economic substance because no reasonable possibility of a profit exists." *Rice's Toyota World Inc. v. Comm'r of Internal Revenue*, 752 F.2d 89, 91 (4th Cir. 1985). A better approach to this sham analysis, which is more flexible and enjoys the support of a majority of the circuits, holds that "the consideration of business purpose and economic substance are simply more precise factors to consider in the [determination of] whether the transaction had any practical economic effects other than the creation of income tax losses." *Sochin v. Comm'r of Internal Revenue*, 843 F.2d 351, 354 (9th Cir), *cert. denied*, 488 U.S. 824 (1988).[22] Nonetheless, what is important for

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[22] *See also Winn-Dixie Stores, Inc. v. Comm'r of Internal Revenue*, 254 F.3d 1313, 1316 (11th Cir. 2001), *cert. denied*, 535 U.S. 986 (2002) (noting that the doctrine has "few bright lines," but clearly applies to "'transactions whose sole function is to produce tax deductions'" (quoting *Kirchman v. Comm'r of Internal Revenue*, 862 F.2d 1486, 1492 (11th Cir. 1989)); *ACM P'ship v. Comm'r of Internal Revenue*, 157 F.3d 231, 247 (3d Cir. 1998), *cert. denied*, 526 U.S. 1017 (1999) ("these distinct aspects of the economic sham inquiry do not constitute discrete prongs of a rigid two-step analysis, but rather represent related factors both of which

our purposes is that, under either approach, the business motives and the reasonable possibility of profit in regards to a transaction executed by the partnership are determined at the partnership level. *See Tallal v. Comm'r of Internal Revenue* , 778 F.2d 275, 276 (5th Cir. 1985); *Transpac Drilling Venture, 1983-2 by Dobbins v. United States*, 32 Fed. Cl. 810, 820 (1995), *aff'd*, 83 F.3d 1410 (Fed. Cir. 1996); *Hawley v. Comm'r of Internal Revenue* , 55 T.C.M. (CCH) 217, 223 (1988). The focus thus is on the partnership's motives in entering into the relevant transaction, "not [on] an individual partner's motive for joining the partnership." *Tallal*, 778 F.3d at 276. This inquiry requires the court to focus "on the actions of those persons selected to manage the affairs of the partnership." *Pasternak v. Comm'r of Internal Revenue*, 990 F.2d 893, 901 (6th Cir. 1993); *see also Simon v. Comm'r of Internal Revenue*, 830 F.2d 499, 507 (3d Cir. 1987). Given this, it is not surprising that courts directly dealing with the sham transaction doctrine have concluded that its application presents a partnership item. *See Transpac*, 32 Fed. Cl. at 820; *see also Nault v. United States*, 2007 WL 465310 at *4-5 (D.N.H. Feb. 9, 2007).

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inform the analysis of whether the transaction had sufficient substance, apart from its tax consequences, to be respected for tax purposes"); *James v. Comm'r of Internal Revenue* , 899 F.2d 905, 908-09 (10th Cir. 1990) (referring to this as the "better approach"); *Rose v. Comm'r of Internal Revenue*, 868 F.2d 851, 854 (6th Cir. 1989) ("the essential inquiry is whether the transaction had any practicable economic effect other than the creation of economic tax losses"). This more generic approach to applying the sham transaction doctrine is more in accord with *Frank Lyon Co. v. United States*, 435 U.S. 561, 583-84 (1978), where the Supreme Court stated that a transaction will be accorded tax recognition only if it has "economic substance which is compelled or encouraged by business or regulatory realities, is imbued with tax-independent considerations, and is not shaped solely by tax-avoidance features that have meaningless labels attached."

So where does this leave us? In fact, the courts have split on whether issues concerning the imposition of interest under section 6621(c) may be raised in a partner-level proceeding. These cases, in many ways, focus on the reverse of this issue – whether the particular issues raised regarding the application of section 6621(c), *e.g.*, whether a transaction is a sham, must be resolved in a partnership-level proceeding. In several decisions, the Tax Court has concluded that "section 6621(c) interest is not a 'partnership item' and is not within the Court's scope of review in a partnership level proceeding." *Affiliated Equip. Leasing II v. Comm'r of Internal Revenue*, 97 T.C. 575, 576-78 (1991) (citing *White v. Comm'r of Internal Revenue* , 95 T.C. 209, 212 (1991)); *see also N.C.F. Energy Partners v. Comm'r of Internal Revenue*, 89 T.C. 741, 744 (1987). Agreeing with this conclusion, the Second Circuit, in *Field v. United States*, 328 F.3d 58, 60 (2d Cir. 2003), held that interest assessed against a partner under section 6621(c) was not a partnership item and thus did not trigger application of section 7422(h). In so concluding, the Second Circuit held that section 6621(c) does not come within the definition of a partnership item. It concluded that such interest neither comes within the statutory definition of partnership items in section 6231(a)(3), because it was authorized by a provision in subtitle F of the Code, nor within the regulatory definition contained in Treas. Reg. §301.6231(a)(3)-1, because it is not specifically listed there. *Field,* 328 F.2d at 59. Rather, the court found that section 6621(c) interest is an affected item, which it decided could be reviewed in a partner-level proceeding. *Id*; *see also Klein v. United States*, 86 F. Supp. 2d at 698 n.12; *Span Hansa Mgmt. Co. v. United States*, 1991 WL 82829 at *3 (W.D. Wash. 1991); *Korchak v. Comm'r of Internal Revenue* , 90 T.C.M. (CCH) 403, 416 (2005).

On the other side of this divide are cases such as *River City Ranches*, 401 F.3d at 1143, in which the Ninth Circuit, reversing a decision of the Tax Court, held that that court

had jurisdiction, in a partnership-level proceeding, "to make factual findings concerning whether the partnerships' transactions were designed merely to secure tax benefits." It reasoned –

> The nature of the partnerships' transactions is a "partnership item" then, because it is "required to be taken into account . . . under . . . [the income tax provisions] of subtitle A," as affecting the income tax of the individual partners. As a "partnership item," the character of the partnership's transactions is within the Tax Court's scope of review.

Id. at 1444. The Ninth Circuit thus concluded that "[t]he Tax Court erred in holding that it had no jurisdiction to make findings concerning the character of the partnerships' transactions, for purposes of the 26 U.S.C. §6621 penalty-interest provisions." *Id.* Subsequent Tax Court decisions applying *River City Ranches,* via that court's so-called *Golsen* rule,[23] have concluded that the court lacks jurisdiction, in a partner-level proceeding, to determine whether a transaction was tax-motivated under former section 6621. *See, e.g., Ertz v. Comm'r of Internal Revenue*, 2007 WL 174133 (U.S. Tax. Court Jan. 24, 2007) ("we cannot determine whether petitioner had substantial underpayments of tax resulting from tax-motivated transactions and shall dismiss for lack of jurisdiction petitioner's claim regarding section 6621(c) interest").

In the court's view several observations flow from these seemingly conflicting cases. Initially, it is important to emphasize what the Ninth Circuit, in *River City Ranches*,

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[23] In *Golsen v. Comm'r of Internal Revenue*, 54 T.C 23 , 742 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971), *cert. denied*, 404 U.S. 940 (1971), the Tax Court held it was bound "to follow a Court of Appeals decision which is squarely [on] point where appeal from our decision lies to that Court of Appeals and to that court alone." 54 T.C. at 757.

did not say. It did ***not*** characterize the section 6621(c) interest as either a partnership item or an affected item. Indeed, it could not have concluded that the imposition of such interest was purely a partnership item because, *inter alia*, that interest was imposed only if there was a substantial understatement of income on the individual return, an issue that obviously cannot be resolved at the partnership level. *See White v. Comm'r of Internal Revenue*, 95 T.C. 209, 212 (1990). Rather, the Ninth Circuit merely concluded that questions concerning the nature of the partnership's transactions – whether they involved a sham, for example – were partnership items that needed to be resolved in a partnership-level proceeding. The latter result can be reconciled with cases like *Field* holding that section 6621(c) interest is an affected item under section 6231(a)(5) – with questions concerning the nature of the partnership's transactions being viewed as affecting the ultimate imposition of interest on an individual partner. Where some of the cases that characterize section 6621(c) as an affected item go astray is in assuming that because that interest is not itself a partnership item, a court is not required to resolve issues concerning the nature of the partnership's transactions in a unified partnership proceeding. As discussed at length above, however, the latter assumption is wrong because the partnership prong of an affected item must be resolved in a partnership-level proceeding, as a necessary precursor to the eventual consideration of the nonpartnership prong in a partner-level proceeding.

To be sure, the nature of what needs to be resolved in the partnership proceeding differs depending upon which sort of "tax-motivated transaction" in section 6621(c) is being asserted by the IRS. To the extent heightened interest is being imposed because the partner participated in a partnership that allegedly conducted a sham transaction, the issue whether the transaction, indeed, was a sham must be resolved first in a partnership-level proceeding, before any consideration can be given in a

refund action to whether the interest should have been imposed on an individual partner. Apart from the analysis above, this result draws strength from Treas. Reg. §301.6231(a)(3)-1(b), which states that partnership items include "whether partnership activities have been engaged in with the intent to make a profit for purposes of section 183." The section 183 inquiry identified in the regulation is very similar to the sham transaction analysis that must be conducted in deciding the partnership prong of the affected item associated with section 6621(c)(3) interest*See Gilman v. Comm'r of Internal Revenue*, 933 F.2d 143, 147-48 (2d Cir. 1991); *Johnson v. United States* , 11 Cl. Ct. 17, 28 (1986); *see also Rose v. Comm'r of Internal Revenue*, 88 T.C. 386, 412-13 (1987). Accordingly, if the section 183 inquiry is a partnership item, so should the sham transaction inquiry. Similarly, to the extent penalty interest is being imposed under the at-risk rules of section 465, any issues involving the nonrecourse character of partnership notes or the economic substance of partnership transactions must first be resolved in a unified partnership proceeding, before any consideration can be given in a refund action as to the extent that an individual partner was actually at risk.

As in the case of plaintiffs' statute of limitations claims, the prerequisite for challenging the imposition of section 6621(c) interest as an affected item has not been met, thereby requiring the court to dismiss plaintiffs' claim for this interest. Again, this result proceeds directly from section 7422(h), as the imposition of section 6621(c) interest is, in part, "attributable to" partnership items. Here, plaintiffs were on notice that one of the issues pending in the unified partnership proceeding was whether the partnership's activities constitutes a series of sham transaction that lacked economic substance, as those assertions were specifically made in the 1991 FPAA. Yet, plaintiffs chose to withdraw from the partnership-level proceeding before the Tax Court, in its July 19, 2001, decision, specifically determined that the transactions

lacked "economic substance, as described in former I.R.C. §6621(c)(3)(A)(v)." Accordingly, the precursor for raising this issue before this court does not exist. And, nothing in plaintiffs' settlement agreements alters this result. Indeed, those agreements seem to envision the imposition of the interest in question, stating that plaintiffs agreed to waive any restrictions on the assessment and collection of any deficiency attributable to partnership items "with interest as required by law." If this language did not resolve the interest issue, then in the court's view, the partnership prong of the section 6621(c) affected item remained alive in the partnership-level proceeding, ultimately to be resolved adversely by the Tax Court. In this regard, the court simply cannot conclude that every partner who enters into a section 6224(c) settlement agreement obtains the right to challenge in an individual partnership proceeding issues that otherwise should be – and in this case were – resolved in a partnership-level proceeding. Indeed, a contrary conclusion would render at least some of the TEFRA partnership provisions a nullity.

Accordingly, the court concludes that it, as well, lacks jurisdiction over plaintiffs' claims regarding the imposition of interest under section 6621(c).

III. CONCLUSION

While plaintiffs assert that a ruling that this court lacks jurisdiction to consider their limitations and interest issues would violate due process, the fact of the matter is that plaintiffs "plight" – if that word is appropriate – is a self-inflicted wound.[24] Plaintiffs had notice, via the FPAA, of the

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[24] Various cases have rejected claims that the TEFRA pa 24 rtnership provisions violate due process, holding that those provisions provide appropriate notice and an opportunity to present their objections. *See, e.g., Transpac Drilling Venture 1982-12 v. Comm'r of Internal Revenue*, 147 F.3d 221, 225 (2d Cir. 1998); *Kaplan*, 133 F.3d at 475; *Walthall v. United States*, 131 F.3d 1289, 1294-95 (9th Cir. 1997); *Klein*, 86 F. Supp.

IRS claims and could have continued with the partnership-level proceeding, which would have left them bound by the adverse decision ultimately rendered by the Tax Court. They chose, however, to settle their cases, only now to contend that they really did not give up anything in exchange for the benefits that the IRS conferred under those agreements and that they instead should be allowed to relitigate issues previously resolved by the Tax Court. Contrary to their claims, however, the language of the relevant TEFRA provisions, including section 7422(h), precludes this result, requiring partners who intend to contest partnership-level issues to do so in the partnership-level proceeding, rather than in subsequent refund suits. Unlike plaintiffs' claims, that construction has the added benefit of construing the TEFRA partnership provisions consistent with their purposes. Plaintiffs have received all the process that is due. Based on the foregoing, the court **GRANTS** defendant's partial motion for dismissal.[25]

IT IS SO ORDERED.

s/ Francis M. Allegra
Francis M. Allegra
Judge

2d at 697 (rejecting similar claims regarding the impact of section 7422(h)).

[25] Based on the foregoing, the court need not address the arguments raised in defendant's second motion to dismiss.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

August Term, 2002

(Argued: April 11, 2003 Decided: May 2, 2003)

Docket No. 02-6163

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DAVID A. FIELD and ELLEN J. FIELD,

Plaintiffs-Appellants,

-v.- 02-6163

UNITED STATES OF AMERICA,

Defendant-Appellee.

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Before: HON. DENNIS JACOBS,
HON. CHESTER J. STRAUB,
Circuit Judges,
HON. GREGORY W. CARMAN,
Chief Judge.[1]

Appeal from a judgment, entered in the United States District Court for the Southern District of New York (Scheindlin, J.), dismissing a complaint for lack of subject matter jurisdiction.

Vacated and remanded.

ELLIOT I. MILLER, New York, NY (David A. Field, on the brief), for Plaintiffs-Appellants David A. Field and Ellen J. Field.

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[1] Honorable Gregory W. Carman, Chief Judge of the United States Court of International Trade, sitting by designation.

MICHAEL M. KRAUSS, Assistant United States Attorney for the Southern District of New York (James B. Comey, United States Attorney, and Jeffrey S. Ostericher, Assistant United States Attorney, on the brief), for Defendant-Appellee United States of America.

PER CURIAM:

The sole issue on appeal is whether the district court had jurisdiction over Plaintiffs-Appellants' tax refund action. This Court holds that jurisdiction is not foreclosed by 26 U.S.C. §7422(h) (2000) and that the district court can properly exercise jurisdiction over this matter. Therefore, the district court's decision is reversed and the case is remanded for consideration of the merits of the action.

District courts generally have subject matter jurisdiction over tax refund claims pursuant to 28 U.S.C. §1346(a)(1). However, under 26 U.S.C. §7422(h), "[n]o action may be brought for a refund attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c)."[2] Based on a plain language reading of the statute, this provision does not bar jurisdiction. The statute indicates that for jurisdiction to be foreclosed, the refund (not the item which leads to that refund) must be attributable to partnership items. In other words, the refund must be based upon the assessment of a partnership item. This reading is further supported by the inclusion of the parenthetical reference to

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[2] Neither exception to §7422(h) is applicable to this case. Plaintiffs-Appellants do not seek a refund based upon a computational error under §6230(c), nor do Plaintiffs-Appellants seek review of the Internal Revenue Service's ("IRS") denial of a request for an administrative adjustment under §6228(b).

§6231(a)(3), which defines a "partnership item." Contrary to the United States' argument, the provision does not appear to bar jurisdiction in refund actions regarding a category of items that are termed "attributable to partnership items." Thus, it is only with respect to partnership items that a refund action is precluded. "If the refund is attributable to partnership items, section 7422(h) applies and deprives the court of jurisdiction. If, on the other hand, the refund is attributable to nonpartnership items, then section 7422(h) is irrelevant, and the general grant of jurisdiction [in 28 U.S.C. §1346(a)(1)] is effective." *Alexander v. United States*, 44 F.3d 328, 331 (5th Cir. 1995).

There are three factors which lead this Court to find that the interest assessed against Plaintiffs-Appellants under former 26 U.S.C. §6621(c) is not a partnership item. First, the statutory definition of a "partnership item" is "any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level." 26 U.S.C. §6231(a)(3). The IRS's regulations list items considered to be partnership items. Thus 26 C.F.R. §301.6231(a)(3)-1 states that "the following items which are required to be taken into account for the taxable year of a partnership under subtitle A of the [Internal Revenue] Code are more appropriately determined at the partnership level than at the partner level and, therefore, are partnership items," and then lists various items, which do not include interest or §6621(c) interest. 26 C.F.R. §301.6231(a)(3)-1. Additionally, former 26 U.S.C. §6621(c) was a part of subtitle F and therefore was not an item "to be taken into account . . . under subtitle A." *Id.* Thus, the statutory definition of a "partnership item" and the IRS's regulations indicate that the §6621(c) interest is not a partnership item. The refund that Plaintiffs seek is therefore not attributable to a partnership item.

Second, the United States Tax Court has previously denied jurisdiction over claims regarding §6621(c) interest on the ground that the §6621(c) interest is not a partnership item. For example, in *Affiliated Equipment Leasing II*, the Tax Court noted its prior holding that it "lack[s] jurisdiction in a partner level proceeding to determine whether a petitioner is liable for increased interest under section 6621(c) where the only matters in dispute were additions to tax" and concluded that "section 6621(c) interest is not a 'partnership item' and is not within the [Tax] Court's scope of review in a partnership level proceeding." *Affiliated Equip. Leasing II v. Commissioner*, 97 T.C. 575, 576-78 (1991) (citing *White v. Commissioner*, 95 T.C. 209, 212 (1991)). As recently as 2000, the Tax Court determined that §6621(c) interest is an "affected item"(as defined in the margin below)[3] rather than a "partnership item" and therefore could not be reviewed at a partnership level proceeding. *Barlow v. Commissioner*, Nos. 4651-95, 4652-95, 6393-95, 6394-95, 2000 Tax Ct. Memo LEXIS 402, at *47-*51 (T.C. Nov. 3, 2000) ("Additional interest under section 6621 is an affected item because the determination of a taxpayer's liability for such interest may require findings of fact peculiar to the particular taxpayer, namely, the amount of the taxpayer's underpayment that is attributable to a tax-motivated transaction. Because the application of section 6621(c) turns on matters that are specific to individual partners, it follows that such interest constitutes an affected item that cannot be reviewed in a

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[3] An "affected item" is defined as "any item to the extent such item is affected by a partnership item." 26 U.S.C. §6231(a)(5). As the Tax Court noted in *Barlow*, there are two types of affected items. The first type "is a computational adjustment made to record the change in a partner's tax liability resulting from the proper treatment of a partnership item." *Barlow*, 2000 Tax Ct. Memo LEXIS 402, at *49 (citation omitted). The second type is an item "that is dependent on factual determinations to be made at the individual partner level." *Id.* at *50. The Tax Court found that §6621(c) interest is the latter type of affected item. *Id.* at *50-*51.

partnership level proceeding.") (citations omitted). These cases reinforce the view that the penalty interest at issue in this case is not attributable to a partnership item.

Third, the parties agree that the §6621(c) interest at issue is not a "partnership item." Counsel for the United States conceded at oral argument that the item at issue is not a partnership item but rather is properly considered an affected item. Plaintiffs have consistently argued that the penalty interest is not a partnership item. The United States argues that §7422(h) should be read to bar jurisdiction over claims for refunds where the item to be refunded is "attributable to a

partnership item," meaning it directly flows from a partnership item. As discussed, a plain reading of §7422(h) defeats of this argument.

For the reasons set forth above, the judgment of the district court is hereby vacated and the matter remanded for consideration on the merits.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Argued: Dec. 19, 1988

Decided: Jan. 20, 1989

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JOSEPH M. IROM,

Appellee,

-v.- No. 596 88-4117

COMMISSIONER OF
INTERNAL REVENUE

Appellant.

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Jonathan S. Cohen, Tax Div., Dept. of Justice, Washington, D.C., on the brief), for respondent-appellant.

Joseph M. Irom, New York City, pro se.

Before FEINBERG, NEWMAN and ALTIMARI, Circuit Judges.

JON O. NEWMAN, Circuit Judge:

The Commissioner of Internal Revenue appeals from a judgment of the United States Tax Court (Samuel B. Sterrett, Judge) declining to hold Joseph M. Irom liable for additional interest on a deficiency in his 1980 income taxes. We vacate in part and remand.

Background

The Internal Revenue Code imposes additional interest penalties on any substantial underpayment "attributable to tax motivated transactions." 26 U.S.C. §6621(c)(1) (Supp. IV

1986).[1] The Code lists five types of transactions that are considered "tax motivated," including "any loss disallowed by reason of section 465(a)." 26 U.S.C. §6621(c)(3)(A)(ii) (Supp. IV 1986). Section 465(a) allows deduction of losses only to the extent that a taxpayer is "at risk." 26 U.S.C. §465(a) (1982 & Supp. IV 1986).

Appellee Irom invested in a coal mining tax shelter in 1979 and reported a $162,500 loss from that investment on his 1980 federal income tax return. The Commissioner disallowed the deduction because the loss did not meet the requirements for deducting advanced minimum annual royalty payments under 26 C.F.R. §1.612-3(b)(3) (1988). The Commissioner noted that the promissory note executed by Irom as part of the investment was not a bona fide debt obligation. The Commissioner asserted a tax deficiency of $80,403.

The Commissioner also notified Irom that he was liable for additional interest on the deficiency pursuant to section 6621(c) because the deficiency was "attributable to tax motivated transactions."

Irom petitioned for a hearing in the United States Tax Court. In his answer, the Commissioner reasserted the deficiency and asked for a determination of additional interest pursuant to section 6621(c).

The Commissioner then moved for summary judgment, claiming as grounds for the deficiency that the taxpayer did not meet the requirements for deducting advanced royalty payments. The Commissioner also sought a determination of additional interest pursuant to section 6621(c) because the loss deduction was disallowed under the "at risk" rules

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[1] Congress redesignated former subsection (d) of section 6621 as (c) in a 1986 amendment. Tax Reform Act of 1986, Pub.L. No. 99-514, §1511(a), (c)(1)(A), 100 Stat. 2085, 2744. In all subsequent references, this opinion will refer to former section 6621(d) as section 6621(c).

of section 465(a) and was therefore a tax motivated transaction. The Commissioner did not, however, specifically assert the "at risk" rules as an alternative ground for the deficiency itself. The taxpayer cross-moved for summary judgment solely on the issue of his liability for additional interest.

The Tax Court granted summary judgment to the Commissioner on the deficiency on the ground that the taxpayer did not meet the requirements for deduction of advanced royalties. The Tax Court granted summary judgment to the taxpayer, however, on the issue of additional interest. The Tax Court said that it could not order additional interest because the only ground asserted for the deficiency was the advanced royalties issue. The Court refused to consider whether the deficiency might also have been based on the "at risk" rules, which would have entitled the Commissioner to assess additional interest.

The Commissioner appeals from the portion of the judgment denying additional interest. Irom does not challenge the deficiency itself.

Discussion

The Tax Court declined to consider the Commissioner's entitlement to additional interest because the Commissioner's summary judgment motion had asserted a ground for deficiency (royalty payment requirements) that was not a ground for additional interest. After deciding the deficiency issue on one ground, the Court was not willing to consider an alternative ground for the deficiency (no "at risk" investment) that would have warranted additional interest. The Court took this position even though in the course of deciding that the taxpayer did not meet the requirements for deducting royalty payments, the Court concluded that the taxpayer's financing arrangement was non-recourse and that the taxpayer was not "at risk."

As a matter of convenience, the Tax Court's position is plausible. If there are two grounds that may support a deficiency, one of which supports additional interest and one of which does not, the Court may be saved some time if the Commissioner sets forth both grounds. The Court can then consider the ground that may support both a deficiency and additional interest, without having to reach the second ground for the deficiency. Although this may be a preferable practice, we find no support in the Internal Revenue Code for requiring the Commissioner to plead in this manner on summary judgment to prevail on a claim for additional interest.

The Code specifies a penalty of additional interest for underpayments "attributable" to tax-motivated transactions. The ordinary, dictionary meaning of "attributable" is "capable of being attributed." *Webster's Third New International Dictionary* 141 (1976 ed.). We think that is the meaning Congress intended. We do not think Congress intended to preclude additional interest for deficiencies that are *capable* of being attributed to tax-motivated transactions simply because the Commissioner seeks summary judgment for the deficiency on other grounds.

Although the Commissioner asserted a ground for underpayment that did not make the taxpayer liable for additional interest, he also contended that the deficiency was capable of being attributed to a tax-motivated transaction that would make the taxpayer liable for such interest. Thus, even though the Tax Court found a deficiency on the first ground, it should also have considered whether a deficiency was capable of being attributed to the second ground, which would have entailed additional interest.

We note that the Commissioner's original notice to Irom asserted that the transactions were tax motivated and subject to additional interest, and the Commissioner's

answer to Irom's petition to the Tax Court requested a determination of additional interest under section 6621(c). Although the Commissioner did not assert the "at risk" provisions as a ground for deficiency on summary judgment, the Commissioner could have reasserted that ground if the case had gone to trial. Moreover, the Commissioner's motion for summary judgment also directly asserted that additional interest was warranted because the transaction was tax motivated.

Thus, unlike *Law v. Commissioner of Internal Revenue,* 84 T.C. 985 (1985), this is not a case in which the Commissioner sought to amend his answer to claim additional interest after the case had been tried and briefed. Here, both the taxpayer and the Tax Court were fully on notice of the Commissioner's position that the transaction was tax motivated and that the Commissioner was seeking additional interest on that basis.

We also find inapposite *Todd v. Commissioner of Internal Revenue,* 862 F.2d 540 (5th Cir.1988), which dealt with the applicability of additional interest under a different section of the Code, 26 U.S.C. §6659 (1982). In *Todd,* the Tax Court had found that a deficiency was not "attributable to" the taxpayer's overvaluation of his investment in refrigerated food containers because the containers were not placed in service during the relevant tax year. Thus, there was no permissible deduction that could have been overvalued. The disallowance of the deduction was independent of and wholly separable from the alleged overvaluation.

In contrast, the Tax Court here found that Irom's investment did not meet the requirements for advanced royalty payments because his financing was non-recourse. The finding of a deficiency on the royalty grounds thus appears to have been inseparable from a finding that the taxpayer was not "at risk" in the transaction.

The Fifth Circuit in *Todd* also relied on legislative materials suggesting that the amount of a deficiency "attributable to" an overvaluation should be calculated only after subtracting deficiencies based on other grounds. 862 F.2d at 541. A similar subtraction is warranted here if on remand the Tax Court finds that none, or only part, of Irom's deficiency is attributable to a transaction that was not "at risk." But if, as the Tax Court's opinion in this case suggests, the two grounds for deficiency are inseparable, then no subtraction is warranted.

We conclude that the Tax Court should have decided whether additional interest was warranted on the grounds asserted by the Commissioner. We vacate that portion of the Tax Court's judgment rejecting additional interest and remand to the Tax Court to make that determination.

FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MICHAEL W. KELLER, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 06-75466 Tax Ct. No. 7530-04L

GARY W. MCDONOUGH, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-70644 Tax Ct. No. 1201-05L

WILLIAM H. LINDLEY; JO ANNE LINDLEY, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-71715 Tax Ct. No. 6657-05L

DONALD ERTZ, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-71719 Tax Ct. No. 20336-04

FRANKLIN HUBBART; JANETTA HUBBART, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-72001 Tax Ct. No. 18722-04L

ROGER CARTER; LORA CARTER, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-72003 Tax Ct. No. 20719-04

DANIEL O. ABELEIN, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-72004 Tax Ct. No. 24804-04L

BOBBIE E. JOHNSON, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-72010 Tax Ct. No. 20775-04L

GORDON FREEMAN; ILENE FREEMAN, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-72073 Tax Ct. No. 24215-04L

ESTATE OF CAROL ANDREWS, Deceased; ROBERT ANDREWS, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-72093 Tax Ct. No. 18174-04

ROY BARNES; ANTONETTE BARNES, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-72114 Tax Ct. No. 10788-05

ROGER D. CATLOW; MARY M. CATLOW, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-72139 Tax Ct. No. 11319-05

BARRY BLONDHEIM; SHERRY BLONDHEIM, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-72654 Tax Ct. No. 15549-05L

DONALD CLAYTON; YVONNE CLAYTON, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-72655 Tax Ct. No. 17704-05L

GARY HANSEN; JOHNEAN F. HANSEN, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-72737 Tax Ct. No. 11175-05L

MARTIN SMITH; SHARON SMITH, *Petitioner-Appellant,* v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	No. 07-73038 Tax Ct. No. 3876-05L

OPINION

Appeals from the United States Tax Court
Harry A. Haines, United States Tax Court Judge,
and David Laro, United States Tax Court Judge,
Presiding

Argued and Submitted February 3, 2009
Submission Vacated February 4, 2009
Submitted May 27, 2009
Seattle, Washington

Filed June 3, 2009

Before: Betty B. Fletcher, Pamela Ann Rymer and Raymond C. Fisher, Circuit Judges.

Opinion by Judge Rymer

COUNSEL

Terri A. Merriam, Merriam & Associates, P.C., Seattle, Washington, for the petitioners-appellants.

Anthony T. Sheehan, Tax Division, Department of Justice, Washington, D.C., for the respondent-appellee.

OPINION

RYMER, Circuit Judge:

These consolidated appeals concern the outstanding tax liabilities for sixteen Taxpayers (as we shall refer to the individual partners) who invested in cattle partnerships operated by Walter J. Hoyt III. Their appeals are taken from the decision of the Tax Court holding that the Commissioner of Internal Revenue did not abuse his discretion in rejecting Taxpayers' offers-in-compromise. In collection due process hearings Taxpayers also challenged the imposition of interest under former 26 U.S.C. §6621(c).[1]

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[1] All of the partnerships involved in these consolidated actions were subject

to the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, 96 Stat. 324. The version of §6621(c) that was in effect for the relevant tax years, 1985 and 1986, increased the statutory interest rate by 120 percent for a "substantial underpayment attributable to tax motivated transactions." §6621(c) (1988). This version of §6621(c) was

The Tax Court held that it lacked jurisdiction in partner-level proceedings to determine whether the partnerships' transactions were tax motivated for purposes of §6621(c).[2] The effect was to leave standing the Commissioner's inclusion of §6621(c) interest in his determination of outstanding liabilities. Taxpayers appeal this decision as well.

We agree with the Tax Court's disposition on the offers-in-compromise, and with its view that, under *River City Ranches #1 Ltd. v. Commissioner*, 401 F.3d 1136, 1144 (9th Cir. 2005), whether transactions were tax motivated is a partnership item to be determined at partnership-level proceedings. The problem in these cases is that the partnership-level proceedings were completed and the judgment had become final before *River City Ranches #1* announced this rule. As the Tax Court has jurisdiction in partner-level proceedings to determine issues relating to liability that the taxpayer has had no opportunity to contest, §6330(c)(2)(B), we believe the court could decide whether the partnership transactions were tax motivated based on the record in the partnership-level proceedings. We are as well situated as the Tax Court to undertake this review and, having done so, we conclude that the record of the partnership-level proceedings shows that the partnerships' transactions were in fact tax motivated.

Accordingly, we affirm in part, vacate in part, and permit the Commissioner to proceed with collection actions as determined by the Notices of Determination.

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repealed in 1990. Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, §7721(b), 103 Stat. 2106, 2399 (1989).

[2] All statutory references are to the Internal Revenue Code as codified in Title 26 of the United States Code, unless otherwise noted.

This is another in a growing line of cases arising out of the tangled tax liabilities of Hoyt partnerships. *See, e.g.*, *Keller v. Comm'r*, 556 F.3d 1056 (9th Cir. 2009); *Hansen v. Comm'r*, 471 F.3d 1021 (9th Cir. 2006); *River City Ranches #1*, 401 F.3d 1136; *Adams v. Johnson*, 355 F.3d 1179 (9th Cir. 2004); *Abelein v. United States*, 323 F.3d 1210 (9th Cir. 2003); *Phillips v. Comm'r*, 272 F.3d 1172 (9th Cir. 2001). To make a long story short, Hoyt organized, promoted, and operated more than 100 cattle- and sheep-breeding partnerships from the 1970s through the 1990s. The cattle partnerships relevant to these appeals were touted as "The 1,000 lb Tax Shelter." Taxpayers invested in one or more of them.

The Commissioner sought to disallow tax benefits claimed by early partnerships, but lost in the Tax Court in 1989. *See Bales v. Comm'r* , 58 T.C.M. (CCH) 431 (1989). After *Bales* , the Commissioner began to conduct a professional headcount of the Hoyt livestock.

Upon receipt of Notices of Final Partnership Administrative Adjustment (FPAA), Hoyt, who was the tax matters partner (TMP) for each of the partnerships, filed petitions with the Tax Court. Hoyt and the Commissioner settled a number of issues in a May 20, 1993 global settlement agreement that established a $4,000 value for each cow and a formula for determining the actual number of cattle owned by each partnership. [3] The Tax Court determined partnership- evel adjustments in accordance with the 1993 Agreement, and issued opinions in 1996 resolving disagreements between Hoyt and the IRS over allocation of the 1980 through 1986 settlement items to the

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[3] Proceedings to revoke Hoyt's status as an Enrolled Agent were initiated in 1997. He was then indicted, and convicted on thirty-one counts of mail fraud (among other things) on February 12, 2001. *United States v. Hoyt*, No. CR-98-529 (D. Or. 2001), *aff'd*, 47 Fed. Appx. 834 (9th Cir. 2002). Taxpayers were identified as victims.

individual partners. *See Shorthorn Genetic Eng'g 1982-2, Ltd. v. Comm'r*, 72 T.C.M. (CCH) 1306 (1996) (*SGE 82-2*).

Meanwhile, the Commissioner offered a variety of settlements to individual partners that waived accuracy-related penalties, including tax-motivated interest in some instances. When the IRS sent notices of intent to levy, Taxpayers requested a collection due process hearing before the Office of Appeals and submitted their own offers-in-compromise pursuant to §6330(c)(2)(A)(iii). The standard offer was for Taxpayers to pay all Hoyt tax deficiencies for all years and regular interest accrued through April 15, 1993. The offers were based on grounds of public policy and equity, and eleven Taxpayers also claimed doubt as to collectibility with special circumstances or economic hardship.

The Commissioner's settlement officers issued a Notice of Determination in each case rejecting the compromise offer and upholding collection. In response to the Notices of Determination, Taxpayers petitioned the Tax Court to review whether the Commissioner abused his discretion in sustaining the proposed collection action, and whether Taxpayers are liable for the increased rate of interest on tax-motivated transactions under §6621(c). The Tax Court held that the settlement officers had not abused their discretion in rejecting Taxpayers' offers-in-compromise or in upholding the proposed levies.

Those Taxpayers who were subject to §6621(c) penalties agreed to be treated as if they were in the same partnership as Donald C. Ertz, that is the Durham Engineering 1985-5 (DGE 85-5) partnership.[4] For the relevant DGE 85-5 tax

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[4] These taxpayers are Daniel O. Abelein, Estate of Carol Andrews and Robert Andrews, Roy and Antonette Barnes, Barry and Sherry Blondheim, Roger and Lora Carter, Roger D. and Mary M. Catlow, Donald and Yvonne Clayton, Gordon and Ilene Freeman, Franklin and

years, 1985 and 1986, the Commissioner sent FPAAs in 1989 and 1990, respectively, that noted the applicability of §6621(c). In the *DGE 85-5* partnership-level proceedings, the Tax Court applied the 1993 Agreement to adjust DGE 85-5's reported depreciation expenses for 1985 from $669,910 to $68,400 and its qualified investment property from $4,701,120 to $480,000; DGE 85-5's depreciation expenses for 1986 were reduced from $982,534 to $161,040. It also concluded that interest for tax-motivated transactions pursuant to §6221(c) was an affected item that requires factual determinations to be made at the partner level and that it therefore lacked jurisdiction over the penalties. *See DGE 85-5 v. Comm'r*, No. 22070- 89, at 14-15 (T.C. Nov. 27, 1996); *DGE 85-5 v. Comm'r*, No. 28577-90, at 14-16 (T.C. Nov. 27, 1996). [5] In these partner-level proceedings, the Tax Court declined jurisdiction over the Ertz Taxpayers' challenge to tax-motivated interest given that *River City Ranches #1* had held that the character of a partnership's transactions is a partnership item to be determined at the partnership level, and no findings had been made on the §6621(c) issue at the partnership-level proceeding in *DGE 85-5*.

Taxpayers timely appealed.

Janetta Hubbart, Bobbie E. Johnson, and Martin and Sharon Smith. When appropriate, we will refer to them collectively as "Ertz Taxpayers," and to their partnerships collectively as "DGE 85-5."

[5] The Tax Court had adhered to the same view in *River City Ranches #1*, 85 T.C.M. (CCH) 1365 (2003), which, unlike *DGE 85-5*, was appealed. In *River City Ranches #1*, we rejected the Tax Court's view that jurisdiction over §6621(c) penalties lies only in partner-level proceedings, holding instead that the court has jurisdiction at the *partnership* level to make findings concerning the imposition of penalty interest under §6621(c). 401 F.3d at 1138, 1143- 4.

II

We review Tax Court decisions "in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury." §7482(a)(1); *Fargo v. Comm'r*, 447 F.3d 706, 709 (9th Cir. 2006). Therefore, review of factual findings is under the clearly erroneous standard and review of questions of law is *de novo*. *Fargo*, 447 F.3d at 709; *Millenbach v. Comm'r* , 318 F.3d 924, 930 (9th Cir. 2003). Like the Tax Court, our review of the decision by the Commissioner whether to accept an offer-in-compromise is for an abuse of discretion. *Fargo*, 447 F.3d at 709. "Abuse of discretion occurs when a decision is based on an erroneous view of the law or a clearly erroneous assessment of the facts." *Id.* (internal quotation marks omitted). We review factual findings underlying the imposition of a penalty under §6621(c) for clear error, and the legal conclusions *de novo*. *See Keller* , 556 F.3d at 1058-59; *Wolf v. Comm'r*, 4 F.3d 709, 715 (9th Cir. 1993); *Gainer v. Comm'r* , 893 F.2d 225, 226 (9th Cir. 1990).

III

[1] Congress authorized the Secretary of the Treasury to "compromise any civil or criminal case arising under the internal revenue laws." §7122(a). The statute directs the Secretary to ensure that taxpayers entering into a compromise "have an adequate means to provide for basic living expenses." §7122(d)(2). Congress delegated authority to promulgate more detailed guidelines to the Secretary. §7122(d)(1).

[2] The Secretary's regulations allow compromises for doubt as to liability (which is not at issue here); for doubt as to collectibility; and to promote effective tax administration for economic hardship when collection of the normal amount would leave a taxpayer unable to afford basic living expenses, or where compelling public policy or equity reasons are shown and, due to exceptional circumstances,

collection of the full amount of tax liability would undermine public confidence in the fairness of tax administration whether or not a similarly situated taxpayer may have paid his liability in full. 26 C.F.R. §301.7122-1(b). The regulations constrain compromises to promote effective tax administration (that is, compromises based on economic hardship and on grounds of public policy or equity) to those that would not undermine compliance with the tax laws. *Id.*, §301.7122-1(b)(3)(iii).[6] "The determination whether to accept or reject an offer to compromise will be based upon consideration of all the facts and circumstances . . . ." *Id.* §301.7122-1(c)(1). Once a taxpayer establishes a ground for

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[6] Section 301.7122-1(b)(3), which governs the ground for compromise based on effective tax administration, provides:

> (i) A compromise may be entered into to promote effective tax administration when the Secretary determines that, although collection in full could be achieved, collection of the full liability would cause the taxpayer economic hardship within the meaning of Sec. 301.6343-1.
>
> (ii) If there are no grounds for compromise under paragraphs (b)(1), (2), or (3)(i) of this section, the IRS may compromise to promote effective tax administration where compelling public policy or equity considerations identified by the taxpayer provide a sufficient basis for compromising the liability. Compromise will be justified only where, due to exceptional circumstances, collection of the full liability would undermine public confidence that the tax laws are being administered in a fair and equitable manner. A taxpayer proposing compromise under this paragraph (b)(3)(ii) will be expected to demonstrate circumstances that justify compromise even though a similarly situated taxpayer may have paid his liability in full.
>
> (iii) No compromise to promote effective tax administration may be entered into if compromise of the liability would undermine compliance by taxpayers with the tax laws.

The regulations as such are not challenged in these cases.

compromise, the determination whether to accept the offer is within the Secretary's discretion. *Id.*

A

Eleven Taxpayers[7] in these consolidated cases appeal the Tax Court's ruling affirming denial of their offers-incompromise based on doubt as to collectibility with special circumstances or economic hardship.

[3] A doubt as to collectibility exists where the taxpayer's assets and income are less than the full amount of the outstanding tax liability. 26 C.F.R. §301.7122-1(b)(2), (c)(2). A compromise based on economic hardship may be entered into when, even though the full liability could be collected, it would cause the taxpayer to be unable to pay his reasonable living expenses. *See id* . §§301.6343-1, 301.7122-1(b)(3)(i); *Fargo*, 447 F.3d at 709-710 (noting the statute's focus on basic expenses with an offer-in-compromise alleging economic hardship). [8] Both types of offer trigger the same inquiry into how much of the tax

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[7] Estate of Carol Andrews and Robert Andrews, Roy and Antonette Barnes, Roger and Lora Carter, Roger D. and Mary M. Catlow, Donald and Yvonne Clayton, Donald Ertz, Franklin and Janetta Hubbart, Bobbie E. Johnson, William H. and Jo Anne Lindley, Gary W. McDonough, and Martin and Sharon Smith.

[8] Factors that support, but are not conclusive of, a determination to accept an economic hardship offer include: "(A) Taxpayer is incapable of earning a living because of a long term illness, medical condition, or disability, and it is reasonably foreseeable that taxpayer's financial resources will be exhausted providing for care and support during the course of the condition; (B) Although taxpayer has certain monthly income, that income is exhausted each month in providing for the care of dependents with no other means of support; and (C) Although taxpayer has certain assets, the taxpayer is unable to borrow against the equity in those assets and liquidation of those assets to pay outstanding tax liabilities would render the taxpayer unable to meet basic living expenses." 26 C.F.R. §301.7122- 1(c)(3)(i).

liability can be paid while allowing the taxpayer to retain enough to pay for reasonable living expenses. 26 C.F.R. §§301.6343-1(b)(4) (economic hardship means "unable to pay his or her reasonable basic living expenses"); 301.7122-1(b)(2), (3); 301.7122-1(c)(2)(i) ("[a] determination of doubt as to collectibility will include a determination of ability to pay . . . [while] permit[ting] taxpayers to retain sufficient funds to pay basic living expenses").

[4] Under IRS guidelines, the Commissioner may accept a doubt as to collectibility offer that is less than the taxpayer's "reasonable collection potential" (net equity plus future income plus other components of collectibility) (RCP) if "special circumstances" are present. Rev. Proc. 2003-71, §4.02(2); Internal Revenue Manual §5.8.1.1.3 (2005) (I.R.M.). The factors the IRS considers for a doubt as to collectibility with special circumstances offer are the same as for an economic hardship offer. I.R.M. §5.8.4.3.

For each of the Taxpayers, the Commissioner rejected the offer because it was substantially lower than what the RCP calculation showed the Taxpayer could afford to pay. Taxpayers attack the Commissioner's denial of their offers on multiple grounds, but we see no basis to conclude the Commissioner abused his discretion in any of these cases.

[5] A number of Taxpayers argue the Commissioner should have factored into the RCP calculation higher future medical expenses (Andrews, Barnes, Carters, Catlows, Hubbarts, Ertz, Johnson, Lindleys, [9] McDonough, and Smiths). We cannot say the Commissioner clearly erred in considering medical needs by relying on present medical

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[9] We agree with the Tax Court's determination that the Lindleys abandoned their offer based on doubt as to collectibility with special circumstances or economic hardship; on appeal the Lindleys contend the Commissioner erred even if their offer is treated under the standard for a normal doubt as to collectibility offer.

expenses instead of estimating future increases. *See Fargo*, 447 F.3d at 710 (noting that taxpayers' evidence of future medical needs was thin, ambiguous, and speculative); 26 C.F.R. §301.7122-1(c)(3) (including as a factor in support of hardship that the taxpayer is incapable of earning a living because of a medical condition and it is "reasonably foreseeable" that financial resources will be exhausted providing for care and support).

[6] Some Taxpayers fault the Commissioner for computational mistakes, such as omitting transaction costs or not including a corresponding adjustment to housing expenses when treating the Taxpayer's equity in his home as fully col- lectible (Barnes, Carters, Catlows, Claytons, Ertz, Hubbarts, Johnson, Lindleys, and McDonough). The Commissioner, however, caught and corrected those mistakes to a significant extent in the Tax Court. Moreover, those relying on miscalculations fail to demonstrate that, allowing for the errors, their offers do not remain below their ability to pay. *Cf. City of Sausalito v. O'Neill*, 386 F.3d 1186, 1220 (9th Cir. 2004) (noting the requirement in the Administrative Procedure Act that " 'due account shall be taken of the rule of prejudicial error' " by courts reviewing agency action) (quoting 5 U.S.C. §706). For the same reason, to the extent Ertz is correct that the Commissioner's treatment of his home equity and retirement account as fully collectible is inconsistent with 26 C.F.R. §301.7122- (c)(3)(i)(example 2), he has not shown this error affected the Commissioner's determination that he could afford to pay more than his offer.

A few Taxpayers attempt to undermine the Commissioner's determination based on evidence that was not part of the record before him (Andrews, Carters, Hubbarts, and Johnson). However, our review is confined to the record at the time the Commissioner's decision was rendered. *See Robinette v. Comm'r*, 439 F.3d 455, 459 (8th Cir. 2006) (observing that appellate review is based on "the

administrative record already in existence, not some new record made initially in the reviewing court") (quoting *Camp v. Pitts*, 411 U.S. 138, 142 (1973)); *Northcoast Envtl. Ctr. v. Glickman*, 136 F.3d 660, 665 (9th Cir. 1998).

[7] Beyond this, Taxpayers question whether the Commissioner fully considered their special circumstances, allowed sufficient time to submit information in support of their offers, and provided an opportunity to respond before making a final determination. The Commissioner is not required to perform an investigation, engage in formal fact-finding proceedings, or respond to an offer with a counter-offer. We believe the Commissioner adequately considered each Tax- KELLER v. CIR 6643 payer's offer given the record before him and within the framework established by the statute, regulations, and Manual.[10]

B

Those Taxpayers who sought compromise based on special circumstances or economic hardship but failed on those grounds, join the rest who claim that exceptional circumstances exist based on considerations of public policy and equity for accepting their offers-in-compromise. They point to two in particular: that they were victims of Hoyt's fraud, and that the Commissioner caused undue delays in resolving their individual tax liabilities.

[8] A compromise to promote effective tax administration based on public policy or equity

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[10] We note that this is not necessarily the end of the road. Whether equity is obtainable from an asset is investigated prior to an actual levy, and court approval is required before a principal residence can be seized. 26 U.S.C. §6334(a)(13)(B), (e); 26 C.F.R. §301.6334-1(d). Also, a taxpayer may make a new offer. Taxpayers may be entitled to another collection due process hearing if the IRS seeks to collect by levy. 26 U.S.C. §§6320(b)(2), 6330(b)(2). Finally, the Office of Appeals retains jurisdiction to consider changes in circumstances. 26 U.S.C. §6330(d)(2); 26 C.F.R. §301.6330-1(h).

considerations "will be justified only where, due to exceptional circumstances, collection of the full liability would undermine public confidence that the tax laws are being administered in a fair and equitable manner." *Id.* §301.7122-1(b)(3)(ii). "No compromise to promote effective tax administration may be entered into if compromise of the liability would undermine compliance by taxpayers with the tax laws." *Id.* §301.7122-1(b)(3)(iii).

[9] Taxpayers argue that they were victimized by the Hoyt operation, but no authority requires the Commissioner to accept an offer-in-compromise simply because the taxpayer was a victim of fraud or third-party misdeeds. The Commissioner could certainly consider third-party actions along with Taxpayers' own conduct and motivation for investing in the Hoyt partnerships. However, we have never held that being victimized by a tax shelter scheme is alone sufficient to require compromise. Indeed, we have upheld negligence penalties applied by the Commissioner to Hoyt partners, *see Hansen*, 471 F.3d at 1029, and it would be anomalous to require a reduction in liability based on public policy or equity grounds in these cases. Given all the facts and circumstances of Taxpayers' involvement in the Hoyt partnerships, we cannot say that the Commissioner abused his discretion in rejecting their offers. It was reasonable for him to decide that collection of less than the full liability would undermine public confidence in administration of the tax laws, whereas accepting the offers could "undermine compliance by taxpayers." *See* 26 C.F.R. §§301.7122-1(b)(3)(ii), (iii).

[10] While it did take nearly twenty years to shut down Hoyt's operations and determine individual tax liabilities, the delay is not all that surprising given the complexity of these tax- helter partnerships. The lengthy time required for the Commissioner — and the courts — to unravel how the Hoyt partnerships really worked is part of the risk assumed by those who chose to invest in them. Taxpayers

fault the IRS, rather than the nature of the TEFRA proceedings, for the delay, maintaining that the IRS failed to seek injunctive relief against Hoyt when it knew enough to do so (no later than 1988); waited until 1997 before seeking to revoke Hoyt's status as an Enrolled Agent when it could have done so earlier; and dealt with Hoyt (as TMP) instead of a settlement committee prior to the 1993 Agreement that, among other things, waived the statute of limitations. But focusing on a few steps that the IRS in hindsight might have taken sooner oversimplifies the saga that got side-tracked with the Commissioner's early loss in *Bales*.

[11] Taxpayers also submit that resolution of their tax liability took longer than the "average" amount of time it takes to conclude a tax shelter case. They suggest that delay should somehow be measured by the "average" time, which, they say, is in the range of ten years. However, there is no footing in the statutes or regulations for an arbitrary cut-off, or for requiring the Commissioner to abate penalties and interest once an "average" amount of time for "average" shelters has passed. Indeed, Taxpayers' cases are not that different from *Fargo*, where the individual partners invested in partnerships more than twenty years prior to resolution of their tax liability in our court. [11] We rejected

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[11] *Bales* was tried in 1986 and the opinion, adverse to the Commissioner, was issued in October 1989. The headcount begun by the Commissioner in response to *Bales* had progressed sufficiently by May 1993 for the IRS and Hoyt to enter into a global settlement for tax years 1980 through 1986, and for the IRS to issue FPAAs for later tax years. Partnership-level cases were filed in 1994. The Tax Court issued opinions in 1996 resolving disagreements between Hoyt and the IRS over allocation of the 1980 through 1986 settlement items to the individual partners. *See, e.g.*, *SGE 82-2*. In 1996 and 1997 the court held trials in two test cases for tax years 1987 and later, for which it issued opinions in 1999 and 2000. *See Durham Farms, #1 v. Comm'r*, 79 T.C.M. (CCH) 2009 (2000), *aff'd*, 59 Fed. Appx. 952 (9th Cir. 2003); *River City Ranches #4 v. Comm'r*, 77 T.C.M. (CCH) 2245 (1999), *aff'd*, 23 Fed. Appx. 744 (9th

taxpayers' similar argument there, that delays outside their control should not be held against them. *Fargo*, 447 F.3d at 713-14. Although the IRS *may* resolve longstanding cases by foregoing penalties and interest that have accumulated as a result of delay in determining the taxpayer's liability,[12] no authority says that it *must*. Congress advisedly left settlement decisions to the Commissioner's discretion. We conclude that the Commissioner had discretion to find that full payment of the outstanding tax liabilities in these cases would encourage future investors to take care before investing in similar tax shelters, whereas less than full payment would discourage potential investors from researching and monitoring similar investments.

Taxpayers further take issue with the Commissioner's reliance on the Internal Revenue Manual, §5.8.11 (2005), which gives an example of when an offer-in-compromise may be rejected that is quite close factually to their case but which, they contend, was legal error because the Manual lacks the force of law under *Fargo*.[13] In *Fargo*, taxpayers

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Cir. 2001). The ruling in *River City Ranches #4* was the first on the merits since *Bales* in 1989.

[12] *See* H.R. Rep. No. 105-599, at 289 (1998) (Conf. Rep.) (noting that the IRS may utilize the new authority to make compromises "to resolve longstanding cases by forgoing penalties and interest which have accumulated as a result of delay in determining the taxpayer's liability").

[13] In the example, a taxpayer invests in a nationally-marketed partnership, claims investment tax credits from the partnership, the partnership is then audited, the taxpayer rejects the Commissioner's initial settlement offer, litigation by the partnership upholds the Commissioner's determination, and the taxpayer submits an offer-in-compromise supported by the argument that the tax managing partner is at fault and the statutory rules are unfair. The example suggests that compromise on the grounds of equity "would undermine the purpose of both the penalty and interest provisions at issue and the consistent settlement principles of TEFRA."

relied on the Manual in support of their position, and we held that the Internal Revenue Manual "does not have the force of law and does not confer rights on taxpayers." 447 F.3d at 713. By this we did not mean to suggest that it is legal error for the *Commissioner* to be guided by his own guidelines. Nor are we persuaded by Taxpayers' argument that referencing the Manual's most analogous example deprived them of full consideration of the facts and circumstances surrounding their investment. As settlement officers are required by the regulations to do, 26 C.F.R. §301.7122-1(c)(1), the officers here did look at the facts and circumstances of each case but nevertheless found their decision in Taxpayers' cases was guided by the Manual's example. They did not err in doing so.

Finally, Taxpayers contend that the Commissioner erred by failing to follow the factors that informed the court's decision in *Fargo* affirming the Commissioner's denial of an offer-in-compromise. The factors we identified there as "cutting against" taxpayers were:

> 1) Taxpayers invested in tax shelters, and purely tax-motivated transactions are frowned upon by the Code; 2) no evidence was presented to suggest that Taxpayers were the subject of fraud or deception; 3) the delay that took place was due to well-established TEFRA procedures and the inability of [the TMPs] to negotiate quickly; and 4) the primary incentives created by requiring full payment are to encourage taxpayers to research future investments more carefully and to keep in better contact with financial agents (such as TMPs).

Fargo, 447 F.3d at 714 (footnotes omitted). These factors were neither intended as a mantra to be applied to each offerin- compromise based on grounds of public policy or equity, nor as a minimum requirement for the proper exercise of the Commissioner's discretion. Rather, we mentioned these facts as indicating why, "at the very least,"

the Commissioner did not abuse his discretion in not accepting the offer-incompromise in that case. *Id.* Accordingly, the Commissioner had no legal obligation explicitly to consider each of these factors before rejecting Taxpayers' offers-in-compromise. Even so, as in *Fargo*, there are a number of factors here that also cut against, not in favor of, Taxpayers. Taxpayers invested in a "1,000 lb Tax Shelter" which is "frowned upon." While individual partners may have thought or hoped they were investing in a business that would make money, the program was marketed for its tax benefits. Even considering Hoyt's fraud, investors in Hoyt's partnerships have been unable to avoid negligence penalties. [14] The time it took to resolve these cases was, as in *Fargo*, explicable. Also, "the primary incentives created by requiring full payment are to encourage taxpayers to research future investments more carefully and to keep in better contact with financial agents (such as TMPs)." *Fargo*, 447 F.3d at 714. Finally, reducing the risks of participating in tax shelters would encourage more taxpayers to run those risks.

[12] In sum, we conclude that the Commissioner was not obliged by compelling considerations of public policy or equity to accept Taxpayers' offers-in-compromise.

IV

We now turn to whether the Commissioner may apply the interest penalty of §6621(c) to the tax liability of the twelve Ertz Taxpayers.

[13] TEFRA established a statutory scheme for separately determining the partnership's tax liability and then the resulting liability of individual partners. Under TEFRA, a partnership files an informational return

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[14] *See Hansen*, 471 F.3d at 1029-33; *Mortensen v. Comm'r*, 440 F.3d 375, 387-93 (6th Cir. 2006); *Van Scoten v. Comm'r*, 439 F.3d 1243, 1252-60 (10th Cir. 2006)."

describing the share of income and expenses attributable to its partners; the individual partners then report their pro rata share of the partnership's tax liability on their individual tax returns. §§701, 702, 6221, 6222; *see Kaplan v. United States* , 133 F.3d 469, 471 (7th Cir. 1998). To assure uniformity, TEFRA "intends that adjustments to a partnership tax return be completed in one consistent proceeding before individual partners are assessed for partnership items." *AD Global Fund, LLC ex rel. North Hills Holding, Inc. v. United States* , 481 F.3d 1351, 1355 (Fed. Cir. 2007). Thus, "[a] partnership's tax items, which determine the partners' taxes, are litigated in partnership proceedings — not in the individual partners' cases." *River City Ranches #1* , 401 F.3d at 1144. TEFRA gives a court with jurisdiction over the partnership-level proceedings jurisdiction "to determine all partnership items of the partnership." §6226(f).

[14] Section 6621(c) interest is an "affected item," that is, a partner-level item that is affected by partnership items. §6231(a)(5). "The nature of [a] partnership['s] transactions" for purposes of §6621(c) is a "partnership item." *River City Ranches #1* , 401 F.3d at 1144; *see* §6231(a)(3). Once the 1993 Agreement was reached, the Tax Court determined allocation issues at the partnership level. The difficulty here is KELLER v. CIR 6649 that (consistent with its own then-governing precedent) the court held that §6221(c) interest was an affected item requiring factual determinations at the *partner* level, therefore it was not within the court's jurisdiction in the *partnership* -level proceedings. This decision was not appealed, but Ertz Taxpayers did challenge §6621(c) interest in the collection due process, or partner-level, proceedings. Meanwhile, the Tax Court's similar ruling at the partnership-level proceedings in *River City Ranches #1* was appealed. We reversed and remanded, holding that the Tax Court — at the level of partnership proceedings — had jurisdiction to rule on the character of the partnerships' transactions for

purposes of §6621(c) interest. *River City Ranches #1*, 401 F.3d at 1143-44. In the wake of *River City Ranches #1*, the parties asked the Tax Court in these cases to use the findings, or lack thereof, in the *DGE 85-5* partnership-level proceedings to determine whether their partnership transactions were tax motivated. The court declined to do so, believing that its prior decisions could not fairly be interpreted as making those findings or determinations. Given this, and deferring to our decision in *River City Ranches #1* that the character of a partnership's transactions is a partnership item to be determined at the partnership level, the Tax Court concluded that it lacked jurisdiction to determine DGE 85-5's partnership items, including whether its transactions were tax motivated. Accordingly, it did not decide whether Ertz Taxpayers had substantial underpayments of tax resulting from tax-motivated transactions. The net result is that Ertz Taxpayers owe §6621(c) interest without a court having specifically ruled on any aspect of that interest.

[15] We must decide whether, in these circumstances, the Tax Court had jurisdiction in the partner-level proceedings to determine from findings that were made and from the record adduced in the partnership-level proceedings, whether the partnership transactions were tax motivated or not. We conclude that the Tax Court in these partner-level proceedings had jurisdiction to review the decision and evidence in the partnership-level proceedings for this limited purpose.

[16] The Tax Court clearly has jurisdiction in a collection due process proceeding to consider issues relating to a taxpayer's liability which the taxpayer has had no opportunity to dispute. *See* §6330(c)(2)(B). This is true here of issues relating to Ertz Taxpayers' liability for §6621(c) interest. Unless the Tax Court has jurisdiction to review the partnership-level record, Taxpayers will have no forum for disputing the imposition of §6621 penalties. While *River*

City Ranches #1 recognized that jurisdiction lies in the partnership-level proceeding to decide whether partnership transactions are tax motivated, we did not purport to revoke the Tax Court's residual jurisdiction in a partner-level proceeding to entertain issues over which the taxpayer otherwise would have no review. As the Commissioner included §6621(c) interest in his Notices of Determination, we hold that the Tax Court had jurisdiction to consider Ertz Taxpayers' challenge to the amount of their liability, including liability for additional interest penalties, that the Commissioner determined. In exercising this jurisdiction the Tax Court should not be making an independent judgment at the partner level about whether partnership transactions were tax motivated, but rather should be reviewing the partnership-level proceedings to determine whether the findings and the record there show the character of the partnerships' transactions.

We agree with the Tax Court that no explicit findings were made on partnership-level issues relevant to §6621(c) interest in *DGE 85-5*. However, we disagree that the court needed to stop at this point. Rather, it could consider what was implicitly found as well. *Cf. Botany Worsted Mills v. United States*, 278 U.S. 282, 290 (1929) (noting "[subsidiary] findings will not support a judgment unless . . . the ultimate fact follows from them as a necessary inference and may be held to result as a conclusion of law"). A necessary implication of what was found in *DGE 85-5* is that the outstanding tax liabilities for 1985 and 1986 were attributable to either an overvaluation or a sham transaction. Either way, the transactions were tax motivated.

The applicable (former) version of §6621(c) stated:

> (1) In general. In the case of interest payable under section 6601 with respect to any substantial underpayment attributable to tax motivated transactions, the rate of interest established under

> this section shall be 120 percent of the underpayment rate established under this section.
>
> (2) Substantial underpayment attributable to tax motivated transactions. For purposes of this subsection, the term "substantial underpayment attributable to tax motivated transactions" means any underpayment of taxes imposed by subtitle A for any taxable year which is attributable to 1 or more tax motivated transactions if the amount of the underpayment for such year so attributable exceeds $1,000.
>
> (3) Tax motivated transactions.
>
> (A) In general. For purposes of this subsection, the term "tax motivated transaction" means —
>
> (i) any valuation overstatement (within the meaning of section 6659(c)),
>
> . . .
>
> (v) any sham or fraudulent transaction.

A "valuation overstatement" is defined as "150 percent or more of the amount determined to be the correct amount of such valuation or adjusted basis." §§6621(c), 6659(c). A "sham or fraudulent transaction" is one that has no "practical economic effects other than the creation of income tax losses." *Sochin v. Comm'r*, 843 F.2d 351, 354 (9th Cir. 1988), *abrogated on other grounds as recognized by Keane v. Comm'r*, 865 F.2d 1088, 1092 n. 8 (9th Cir. 1989). The test for a "sham or fraudulent transaction" is whether "the taxpayer has shown 1) a non-tax business purpose (a subjective analysis), and 2) that the transaction had 'economic substance' beyond the generation of tax benefits (an objective analysis)." *Id.*; *see also Sacks v. Comm'r*, 69 F.3d 982, 988 (9th Cir. 1995).

In the partnership-level proceedings, the Tax Court adjusted the qualified investment property of DGE 85-5 from $4,701,120 to $480,000. Ertz Taxpayers argue that this adjustment cannot fit within the definition of overvaluation (150 percent or more of the actual value) without knowing how many cattle were included in each valuation.[15] The 1993 Agreement established a $4,000 per head value for the cattle; thus the adjustment to $480,000 reflects $4,000 multiplied by 120 cows. Ertz Taxpayers suggest that DGE 85-5's initial valuation of $4,701,120 could represent 784 cattle, which would equal $5,996 per head, and then the overvaluation would be less than 150 percent compared to the $4,000 per head valuation agreed upon in the 1993 Agreement. Essentially, the argument is that the partnership-level record does not conclusively reveal whether DGE 85-5 overvalued the actual number of cattle, included nonexistent cattle, or both.

However, no matter how one cuts it, the difference between the claimed value and the adjusted value is attributable to either an overvaluation or sham transaction. Based on the actual number of cows, 120, DGE 85-5's claimed valuation of $4,701,120 represents a per head valuation of $39,176, roughly ten times the actual value of $4,000. On the other hand, to the extent that Ertz Taxpayers did not overvalue their cattle in excess of 150 percent on the assumption that DGE 85-5's tax returns included at least 664 nonexistent cattle, then the disallowed portion of DGE 85-5's claimed tax benefits was based on cattle it never acquired. It follows that those benefits are the result of transactions that fit within the definition of a

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[15] The Commissioner relies on a schedule that was not referenced or incorporated in any stipulation in the partnership-level proceedings. We cannot say that the Tax Court necessarily relied on the numbers contained in the Commissioner's schedule, therefore we do not consider it.

factual sham. Viewed either as an overvaluation or as a sham transaction, the effect is the same: underpayment by DGE 85-5 is necessarily "attributable to" a tax-motivated transaction as defined by §6621(c).

[17] Ertz Taxpayers offer no explanation for the underpayment that escapes imposition of §6621(c) interest. None appears in the record of the partnership-level proceedings. Accordingly, as a Commissioner's ruling "has the support of a presumption of correctness, and the petitioner has the burden of proving it to be wrong," *Welch v. Helvering* , 290 U.S. 111, 115 (1933), we uphold his imposition of §6621(c) interest.

Ertz Taxpayers maintain that an overvaluation penalty should nonetheless not apply when a deduction is disallowed in its entirety. *See Keller*, 556 F.3d at 1059-62; *Gainer*, 893 F.2d at 226. While we have held that where a deduction is disallowed in its entirety, any underpayment is not "attributable to" an overvaluation after taking into consideration the effect of disallowing the deduction, *see Keller*, 556 F.3d at 1060; *Gainer*, 893 F.2d at 226-29, the deduction claimed by DGE 85-5 was not disallowed in its entirety. Therefore, *Gainer* and *Keller* do not apply.

[18] Finally, Ertz Taxpayers submit that a partner-level determination is needed with respect to whether each partner made the valuation overstatement in good faith. Then-existing §6659 authorized the Secretary to waive "all or any part of the addition to the tax provided by this section on a showing by the taxpayer that there was a reasonable basis for the valuation or adjusted basis claimed on the return and that such claim was made in good faith." §6659(e) (1988). By its terms, §6659(e) only applies to a valuation overstatement penalty imposed pursuant to §6659. Section 6621 incorporates the definition of §6659(c) that a valuation overstatement exists "if the value of any property . . . claimed on any return is 150 percent or more of the amount determined to be the correct amount."

Section 6621, however, does not incorporate the discretionary waiver for good faith underpayments in §6659(e). Ertz Taxpayers point to no authority for interpreting the applicable version of §6621 to include a good faith exception. To read the statute this way would require us to hold that a statutory provision that explicitly cross-references one part of another provision also implicitly incorporates another part of that other provision. We decline to do this. *See, e.g.*, *Botosan v. Paul McNally Realty*, 216 F.3d 827, 832 (9th Cir. 2000) ("The incorporation of one statutory provision to the exclusion of another must be presumed intentional under the statutory canon of *expressio unius* ."). It is "unlikely that Congress would absentmindedly forget to adopt a provision that appears a mere two paragraphs below the subsection it adopted." *Id.* (internal quotation marks omitted).

V

Taxpayers raise a number of issues regarding evidentiary decisions by the Tax Court, including to grant the Commissioner's motion in limine excluding extra-record evidence, to limit trial time and restrict testimony, and to decline to enforce a subpoena for documents from the Treasury Inspector General for Tax Administration. We have considered the record on each of these points, and see no abuse of discretion in the Tax Court's rulings.

VI

[19] We conclude that the Commissioner did not abuse his discretion in rejecting offers- n-compromise that did not measure up under IRS guidelines and Treasury Regulations. Contrary to the Tax Court's view, it did have jurisdiction in the partner-level proceedings in these cases to review the record of partnership-level proceedings to determine whether the partnerships' transactions were tax motivated. Having conducted this review ourselves, we are satisfied that the partnership-level record admits of only

one reasonable conclusion — that the partnerships' transactions were either overvalued or sham, thus tax motivated. We therefore vacate the portion of the Tax Court's order and decision in the Ertz Taxpayers' cases that dismisses the claim regarding §6621(c) for lack of jurisdiction. We affirm the order in each of these sixteen cases to the extent it permits the Commissioner to proceed with the collection action as determined in the Notice of Determination Concerning Collection Action(s).

AFFIRMED IN PART; VACATED IN PART.

United States Court of Appeals

for the Federal Circuit

2000-5045

WALTER PROCHORENKO and

OKSANA PROCHORENKO,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendant-Appellee.

Appeal from the United States Court of Federal Claims in 98-CV-754T, Judge Nancy B. Firestone.

DECIDED: March 23, 2001.

Dennis N. Brager, Law Offices of Dennis N. Brager, A.P.C., of Los Angeles, CA, argued for plaintiffs-appellants.

Teresa E. McLaughlin, Attorney, Tax Division, Department of Justice, of Washington, DC, argued for defendant-appellee. With her on the brief was *Teresa T. Milton*, Attorney.

Before LOURIE, SCHALL, and BRYSON, Circuit Judges.

LOURIE, Circuit Judge.

Walter and Oksana Prochorenko appeal from the decision of the United States Court of Federal Claims granting summary judgment in favor of the government and denying the Prochorenkos' motion for summary judgment on their claim for a refund of federal income taxes paid for the years 1982 through 1985. *Prochorenko v. United States*, 45 Fed. Cl. 494 (2000). Because we conclude that the

Prochorenkos are not entitled to reduce their partnership tax liability based on the statutory right to a consistent settlement of "partnership items" under I.R.C. §6224(c)(2), we affirm.

BACKGROUND

After acquiring a limited partnership interest in Syn Fuel Associates in 1982, the Prochorenkos claimed deductions on their joint federal income tax returns for 1982 through 1985 based on their proportional share of the partnership losses. *Id.* at 495. After conducting an audit, the Internal Revenue Service ("IRS") disallowed the claimed partnership losses and issued a Final Partnership Administrative Adjustment ("FPAA") pursuant to the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), Pub.L. No. 97-248, 96 Stat. 324 (1982). *Id.* at 495-96. Subsequently, several partners elected to challenge the FPAA in the United States Tax Court. *Id.* at 496. While the appeal in the Tax Court was still pending, several other partners entered into an agreement with the IRS ("the Craig settlement") under terms that were more favorable to the settling partners than those in the FPAA. *Id.* Dennis Brager, the attorney who represented the settling partners, also represented other Syn Fuel partners who did not enter into the Craig settlement. *Id.*

On March 31, 1993, the Tax Court upheld the FPAA. *Peat Oil & Gas Assocs. v. Comm'r,* 100 T.C. 271, 1993 WL 95582 (1993). On April 30, 1993, Brager sent a letter to all of the non-settling partners that he represented, including the Prochorenkos, informing them of the Tax Court's decision and advising them to request settlements under terms consistent with the Craig settlement. *Prochorenko,* 45 Fed. Cl. at 496. Under I.R.C. §6224(c)(2), if the IRS enters into a settlement agreement "with respect to partnership items" with any partner, other partners have the right to request terms that are consistent with those contained in the previous settlement agreement. Such requests must be

made within 150 days from the day on which notice of the FPAA is mailed to the tax matters partner, or within sixty days from the day on which the prior settlement agreement was entered into. I.R.C. §6224(c)(2); Treas. Reg. §301.6224(c) 3T (2000). In his letter, Brager instructed any clients who were interested in requesting such a settlement to do so by May 10, 1993, which was sixty days after the date that the IRS gave notice of the Craig settlement. *Prochorenko,* 45 Fed. Cl. at 497. The Prochorenkos did not make such a request. *Id.* Instead, the non-settling partners (which by operation of law included the Prochorenkos) appealed to the United States Court of Appeals for the Second Circuit, which affirmed the Tax Court's decision. *Ferguson v. Comm'r,* 29 F.3d 98 (2d Cir.1994).

After paying the disputed taxes, the Prochorenkos learned that another Syn Fuel partner, Anthony Colitti, and his wife had entered into an agreement with the IRS ("the Colitti settlement") on August 17, 1997, under terms that were similar to those granted in the earlier Craig settlement. *Prochorenko,* 45 Fed. Cl. at 497. On May 4, 1995, the Colittis wrote to the IRS seeking "to formalize the agreement that they believe[d] that they entered into." *Id.* at 498. According to the Colittis, they had signified their acceptance of the IRS's earlier settlement offer in 1993. *Id.* Although the IRS disputed the Colittis' contentions as to whether they had timely requested such a settlement, the IRS eventually agreed to settle with the Colittis "through administrative grace only." *Id.* On October 3, 1997, within sixty days from the date the Colitti settlement was finalized, the Prochorenkos filed a request with the IRS for a settlement agreement with terms consistent with the Colitti settlement, which the IRS denied. *Id.* The Prochorenkos subsequently filed tax refund claims for the years 1982 through 1985, based on their request for a consistent settlement, which the IRS also denied. *Id.*

Thereafter, the Prochorenkos filed this suit in the Court of Federal Claims. *Id.* The government filed a motion for summary judgment, and in the alternative, moved for dismissal for lack of jurisdiction. The Prochorenkos filed a cross-motion for summary judgment. The court granted summary judgment in favor of the government, ***1362** concluding that the Prochorenkos had failed to state a claim upon which relief could be granted, and denied the Prochorenkos' corresponding cross-motion. *Id.* at 501. The court concluded that the Prochorenkos were not entitled to a reduction of their partnership tax liability based on the Colitti settlement. *Id.* at 495. The court explained that the Colitti settlement did not trigger the right to a consistent settlement under I.R.C. §6224(c)(2) because it was not a settlement "with respect to partnership items." *Id.* at 501. The Prochorenkos now appeal to this court. We have jurisdiction pursuant to 28 U.S.C .A §1295(a)(3) (West Supp.2000).

DISCUSSION

We review the Court of Federal Claims' grant of a motion for summary judgment "completely and independently, construing the facts in the light most favorable to the non-moving party." *Am. Airlines, Inc. v. United States,* 204 F.3d 1103, 1108 (Fed.Cir.2000) (quoting *Good v. United States,* 189 F.3d 1355, 1360 (Fed.Cir.1999)). In reviewing a denial of a motion for summary judgment, we give considerable deference to the trial court, and "will not disturb the trial court's denial of summary judgment unless we find that the court has indeed abused its discretion." *SuntTiger, Inc. v. BluBlocker Corp.,* 189 F.3d 1327, 1333 (Fed.Cir.1999). Summary judgment is appropriate only when there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. *Id.* When both parties move for summary judgment, the court must evaluate each motion on its own merits, resolving all reasonable inferences

against the party whose motion is under consideration. *McKay v. United States,* 199 F.3d 1376, 1380 (Fed.Cir.1999). If there are no material facts in dispute precluding summary judgment, our task is to determine whether the judgment granted is correct as a matter of law. *Bankers Trust N.Y. Corp. v. United States,* 225 F.3d 1368, 1372 (Fed.Cir.2000).

A. *Jurisdiction*

Before we reach the merits of the Prochorenkos' appeal, we must first address the government's contention that the Court of Federal Claims lacked jurisdiction over the Prochorenkos' tax refund claim because the United States has not waived its sovereign immunity with respect to such claims. The Court of Federal Claims declined to decide this issue in light of its conclusion that the Prochorenkos failed to state a claim for which relief could be granted. Establishment of jurisdiction, however, is a prerequisite to a decision on the merits. We will therefore determine first whether the Court of Federal Claims had jurisdiction over the Prochorenkos' claim.

The government contends that the Prochorenkos' suit is barred by I.R.C. §7422(h), which precludes suits "for a refund attributable to partnership items." The government argues that the Prochorenkos' claim does not fall within the scope of I.R.C. §6230(c)(1)(B), which allows a partner to file a refund claim for overpayments "attributable to the application to the partner of a settlement." The government contends that this express exception only applies to a partner who is bound by a settlement that the IRS refuses to honor. The Prochorenkos respond that the Court of Federal Claims had jurisdiction to hear their claim under I.R.C. §6230(c)(3), which permits a partner to bring suit if a refund claim under I.R.C. §6230(c)(1)(B) is not allowed. The Prochorenkos contend that I.R.C. §6230(c)(1)(B) allows a partner to file a refund claim for an overpayment due to the failure of the IRS to make a refund based on the

application of a settlement entered into with another partner.

We conclude that the Prochorenkos' claim is not barred by I.R.C. §7422(h) because it is not a claim "for a refund attributable to partnership items." Section 7422(h) provides as follows:

> (h) Special rule for actions with respect to partnership items.--No action may be brought *for a refund attributable to partnership items (as defined in section 6231(a)(3)*) except as provided in section 6228(b) or section 6230(c).

I.R.C. §7422(h) (emphasis added). Section 6231(a)(3), which is located in the subchapter of the Internal Revenue Code that deals with the tax treatment of partnership items, expressly defines the term "partnership items" as follows:

> (3) Partnership item.--The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A *to the extent regulations prescribed by the Secretary provide that,* for purposes of this subtitle, *such item is more appropriately determined at the partnership level than at the partner level.*

I.R.C. §6231(a)(3) (emphasis added).

> Items that are "more appropriately determined at the partnership level than at the partner level and therefore are partnership items" are specifically set forth in the applicable regulation. Treas. Reg. §301.6231(a)(3)- 1(a) (2000). Under this regulation, "partnership items" include items such as the income, gains, losses, deductions, and credits of a partnership, *id.*, but do not include an individual partner's right to request a consistent settlement under I.R.C. §6224(c)(2), *see Monti v. United States,*

223 F.3d 76, 82 (2d Cir.2000). As the Second Circuit explained in *Monti:*

> One partner's right to settlement terms consistent with those granted to another partner is not a partnership item, because the question posed requires consideration of the relationship between one partner's situation and another's and the individual's, rather than the partnership's, communications with the IRS. The facts needed to determine whether consistent terms were offered are facts about the partner, not facts about the partnership.

Id. at 82-83. Accordingly, we conclude that a partner's right to a consistent settlement under I.R.C. §6224(c)(2) is not itself a "partnership item."

While it is true that the Prochorenkos were seeking a refund of partnership taxes, their refund was not "attributable to partnership items." Rather, it was based on their claimed right to a consistent settlement under I.R.C. §6224(c)(2). The Prochorenkos claimed that they were entitled to a reduction of their partnership tax liability based on a settlement that the IRS had entered into with another partner. Whether or not the Prochorenkos were entitled to such a reduction is an issue that is entirely dependent on their own unique factual circumstances, and has no effect on and is not affected by the tax liability of any of the other Syn Fuel partners. Accordingly, this is not the type of issue that is "more appropriately determined at the partnership level." Treas. Reg. §301.6231(a)(3)-1(a). Construing the phrase "attributable to partnership items" so broadly as to cover claims that depend on the unique circumstances of an individual partner, and that only affect that partner, would be contrary to the system of separate treatment of partnership items and nonpartnership items established by Congress in enacting TEFRA. *Monti,* 223 F.3d at 82 (explaining that while, at some level of

generality, most refund claims for partnership taxes can be characterized as a refund "attributable to partnership items," to treat claims that are entirely dependent on facts peculiar to an individual partner would blur the distinction between proceedings involving partnership items and those involving nonpartnership items, and would be contrary to the system established by Congress in enacting TEFRA). We therefore conclude that the Prochorenkos' claim is not for a refund "attributable to partnership items," and that the Court of Federal Claims had jurisdiction to hear the Prochorenkos' claim.

B. *The Colitti Settlement*

We next address the parties' arguments concerning whether the Prochorenkos are entitled to a consistent settlement under §6224(c)(2). The Prochorenkos argue that they are entitled to a settlement consistent with the Colitti settlement, which they characterize as a settlement "with respect to partnership items" that reduced the Colittis' tax liability for partnership items. The Prochorenkos contend that the Court of Federal Claims erred in determining that the Colitti settlement was merely a settlement of the Colittis' claim that they were entitled to a consistent settlement under I.R.C. §6224(c)(2). The Prochorenkos also contend that the IRS had the authority to settle "partnership items" with the Colittis under I.R.C. §§6404(a) and 6224(c)(2), and that even if the IRS did not have such authority, the Colitti settlement still triggered the Prochorenkos' right to request a consistent settlement under I.R.C. §6224(c)(2) because it was voidable and not void *ab initio*.

The government responds that the Prochorenkos are not entitled to a consistent settlement under I.R.C. §6224(c)(2) because the Colitti settlement was not a settlement "with respect to partnership items." The government asserts that the Colitti settlement was instead a settlement of the Colittis' claim that they were entitled to terms consistent

with the earlier Craig settlement, based on their timely election in 1993. The government argues that the IRS compromised with the Colittis based on their unique factual claim, and not on a claim that related to the substantive treatment of Syn Fuel partnership items.

We agree with the government that the Prochorenkos are not entitled to a consistent settlement under I.R.C. §6224(c)(2) because the Colitti settlement was not a settlement agreement "with respect to partnership items." We reach this conclusion based upon the plain language of the relevant statutes. *See Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108, 100 S.Ct. 2051, 64 L.Ed.2d 766 (1980) ("[T]he starting point for interpreting a statute is the language of the statute itself. Absent a clearly expressed legislative intention to the contrary, that language must ordinarily be regarded as conclusive."). Section 6224(c)(2) provides in relevant part as follows:

> (2) Other partners have right to enter into consistent agreements.--If the Secretary enters into a settlement agreement with any partner *with respect to partnership items* for any partnership taxable year, the Secretary shall offer to any other partner who so requests settlement terms for the partnership taxable year which are consistent with those contained in such agreement.

I.R.C. §6224(c)(2) (emphasis added). Thus, according to the plain language of the statute, whether the Prochorenkos are entitled to a consistent settlement under I.R.C. §6224(c)(2) depends on whether the Colitti settlement was a settlement "with respect to partnership items."

The Court of Federal Claims expressly determined that "[t]he undisputed evidence shows that the [Colittis] claimed that they sought a consistent settlement in 1993." *Prochorenko*, 45 Fed. Cl. at 501. The court noted that the Colittis wrote to the IRS on May 4, 1995, seeking "to

formalize the agreement that they believe[d] that they entered into by communicating their desire to accept the settlement offer to the attorney for the partnership." *Id.* at 498. The court further noted that although the IRS disputed the Colittis' contentions, the IRS eventually agreed to settle with the Colittis "on terms similar to the 'Craig settlement.' " *Id.* Thus, the record supports the court's determination that the Colitti settlement was a settlement of the Colittis' factual claim that they were entitled to terms consistent with the Craig settlement, based on their request in 1993, rather than a settlement of partnership items. In other words, the Colitti settlement specifically resolved the issue whether the Colittis had a right to a consistent settlement under I.R.C. §6224(c)(2), based on their unique factual circumstances.

In light of our earlier determination that a partner's right to a consistent settlement under I.R.C. §6224(c)(2) is not a "partnership item," we conclude that the Colitti settlement was not a settlement "with respect to partnership items." While the Colitti settlement effectively reduced the Colittis' tax liability for "partnership items," the Colitti settlement itself was not a settlement "with respect to partnership items" because it arose from a claim that was "entirely dependent on facts peculiar to a single partner." *Monti,* 223 F.3d at 82. Whether the Colittis had made a timely request for a settlement offer with consistent terms is a specific factual question that relates solely to the Colittis, and does not relate to the substantive treatment of Syn Fuel partnership items. Accordingly, the Colitti settlement was not a settlement "with respect to partnership items" that triggered the rights of other partners to obtain a consistent settlement under I.R.C. §6224(c)(2).

In its decision, the Court of Federal Claims concluded that the Colitti settlement could not have been a settlement of partnership items that triggered the rights of other

parties under I.R.C. §6224(c)(2) because the IRS did not have the legal authority to settle partnership items once a final judgment on a contested FPAA has been entered. However, having reached the conclusion that the Colitti settlement was not a settlement "with respect to partnership items" on grounds distinct from those relied on by the Court of Federal Claims, it is unnecessary for this court to reach the parties' arguments concerning that issue.

We note that the very same basis that provides for jurisdiction in this case, *i.e.*, that the Prochorenkos' claimed right to a consistent settlement under I.R.C. §6224(c)(2) is not itself a partnership item, also deprives the Prochorenkos of the right to a settlement consistent with the Colitti settlement, because that settlement was not a settlement "with respect to partnership items." The Prochorenkos could have requested a settlement consistent with the earlier Craig settlement, but they failed to do so within 150 days after notice was given to the tax matters partner, or within sixty days after the date the settlement was entered into. *See* I.R.C. §6224(c)(2); Treas. Reg. §301.6224(c) 3T. Thus, the Prochorenkos were not entitled to a consistent settlement under I.R.C. §6224(c)(2).

The Prochorenkos contend that the Court of Federal Claims' determination, that the IRS had settled the Colittis' claim that they were entitled to a consistent settlement, is contrary to the record evidence because, *inter alia:* (1) the Colittis never claimed that they submitted a timely request to the IRS; and (2) the Colitti settlement had more favorable terms than the Craig settlement. We disagree. While the Colittis may not have specifically contended that they submitted their request directly to the IRS, it is undisputed that the Colittis did claim that they had timely requested a consistent settlement under I.R.C. §6224(c)(2) by communicating their acceptance of the IRS's settlement offer (*viz.*, the Craig settlement) to the attorney for the partnership. *Prochorenko,* 45 Fed. Cl. at 498. Whether or

not the Colittis properly made such a request to the IRS does not alter the fact that they claimed that they were entitled to a consistent settlement, and that the Colitti settlement ultimately resolved that claim.

Likewise, although there may have been slight differences in the terms of the Colitti and Craig settlements, that does not negate the fact that the Colitti settlement originated from the Colittis' factual claim that they were entitled to a settlement consistent with the Craig settlement. Furthermore, the Prochorenkos do not dispute the government's assertion that the differences between the Colitti settlement and the Craig settlement primarily concerned certain "nonpartnership items" (*i.e.,* penalties and tax-motivated interest), and that the IRS was not required to grant consistent settlement terms with respect to such items. Accordingly, none of the Prochorenkos' factual assertions contradict ***1366** the Court of Federal Claims' determination that the Colitti settlement was a settlement of the Colittis' claim that they were entitled to a consistent settlement under I.R.C. §6224(c)(2).

We have carefully considered the Prochorenkos' other arguments concerning this issue, but find them lacking in merit.

C. *Discovery*

As a final matter, the Prochorenkos argue that the Court of Federal Claims abused its discretion in denying their request for further discovery. The Prochorenkos contend that they were entitled to discovery of all documents relating to the Colitti settlement, including evidence as to what the IRS staff believed that they were settling, because there was a material question as to the nature of the Colitti settlement. The government responds that the Court of Federal Claims properly exercised its discretion in denying the Prochorenkos' discovery request because further discovery would not have altered the court's

conclusion that the Prochorenkos were not entitled to a consistent settlement.

We agree with the government that the Court of Federal Claims did not abuse its discretion in denying the Prochorenkos' discovery request. First, an abuse of discretion standard is a difficult one to meet on appeal. No abuse has been shown here. Moreover, as explained above, the evidence of record supports the court's determination that the Colitti settlement was a settlement of the Colittis' claim that they were entitled to a consistent settlement under I.R.C. §6224(c)(2). Thus, given that the Colitti settlement was not a settlement of "partnership items," additional discovery would not have altered the court's conclusion that the Prochorenkos had no right to a settlement consistent with the Colitti settlement under I.R.C. §6224(c)(2).

CONCLUSION

For the above reasons, we conclude that the Prochorenkos are not entitled to reduce their partnership tax liability based on the statutory right to a consistent settlement of "partnership items" under I.R.C. §6224(c)(2). Accordingly, we

AFFIRM.

BRYSON, *Circuit Judge,* dissenting:

I would not reach the merits of this dispute but would hold that the Court of Federal Claims lacked jurisdiction to entertain the Prochorenkos' claim. I therefore respectfully dissent on that issue.

The first step in the jurisdictional analysis is 26 U.S.C. §7422(h), which provides that no action may be brought "for a refund attributable to partnership items" except as provided in 26 U.S.C. §§6228(b) or 6230(c). The court holds that the Prochorenkos' claim is not barred by section 7422(h) because their claim is not "for a refund attributable

to partnership items," but instead is for treatment consistent with that given to the taxpayers in the Colitti settlement. Although the matter is debatable, I would not characterize the Prochorenkos' claim in that way. To be sure, the Prochorenkos are asking to be treated consistently with the Colittis, but the tax items as to which they are seeking consistent treatment are partnership items. The Prochorenkos' tax liability, and thus their right to a refund if they are entitled to one, relates to the tax treatment of those partnership items. The substance of their claim is therefore "attributable to partnership items" in the ordinary sense of that phrase. The Seventh Circuit agrees with this analysis, *see Kaplan v. United States,* 133 F.3d 469, 473 (7th Cir.1998), although the Second Circuit does not, *see Monti v. United States,* 223 F.3d 76, 82 (2d Cir.2000). Because the Prochorenkos are seeking a refund that stems from the tax treatment of partnership items, I think the Seventh Circuit's interpretation of section 7422(h) in *Kaplan* is correct and the Second Circuit's interpretation in *Monti* is not.

In *Monti,* the court ruled that an action brought by non-settling partners seeking tax treatment consistent with that accorded to other partners did not fall within the bar of section 7422(h). The Second Circuit reasoned that the Montis' action was not "attributable to partnership items" because their asserted right to consistent treatment depended on facts specific to them and their dealings with the IRS rather than on facts general to the partnership. *Monti,* 223 F.3d at 82. That reasoning, however, would seem to apply as well to other actions brought by individual partners, such as actions claiming errors in the computations or application of partnership items to particular partners, *see* 26 U.S.C. §6230(c)(1), or actions seeking a refund when the Secretary decides to treat a particular partner's partnership items as non-partnership items, *see* 26 U.S.C. §6228(b). Yet such actions fall within the scope of section 7422(h) and are exempted from its ban

only by express exceptions in section 7422(h). The fact that an action turns on facts specific to particular partners therefore does not keep it from being an action "for a refund attributable to partnership items," within the meaning of section 7422(h), as long as the tax issues on which the refund request is based arise from partnership items.

The Prochorenkos do not dispute that section 7422(h) is applicable to their claim; instead, they contend that the Court of Federal Claims has jurisdiction over their complaint because their claim falls within the express exception to section 7422(h) for claims brought under section 6230(c). That subsection provides in pertinent part that a partner may file a claim for a refund on the ground that "the Secretary failed to allow a credit or to make a refund to the partner in the amount of the overpayment attributable to the application to the partner of a settlement...." The Prochorenkos interpret that language to provide an exception for claims based on the failure to give a partner the benefit of a prior partnership settlement. I disagree. Although the statutory language is not entirely clear on this point, it is most naturally interpreted to refer to claims in which the Secretary fails to make a refund or allow a credit in the proper amount based on a prior settlement that *has been* applied to the partner. The Prochorenkos contend that section 6230(c) also includes a claim for a refund that should have been paid based on a prior partnership settlement that *should have been* applied to the partner filing the claim, but the statutory language is not so broad. It refers to a refund "attributable to the application to the partner of a settlement," not to a refund attributable to the erroneous failure to apply a settlement to the partner. The narrower reading of section 6230(c)(1)(B) is not only more consistent with the statutory language, but it is also more in accordance with the title of the subsection, "Claims arising out of erroneous computations, etc." Consistent with the title, the subsection is most naturally read to apply to errors resulting from

mistakes in applying the terms of a prior settlement to the suing partner, not to the Secretary's refusal to make a prior settlement applicable to the suing partner at all. Because I am persuaded that the bar of section 7422(h) applies to the Prochorenkos' claim and that the exception to that bar in section 6230(c) does not, I would vacate the judgment in this case and remand with directions to dismiss the complaint for lack of jurisdiction.

FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

RIVER CITY RANCHES #1 LTD., LEON SHEPARD, TAX MATTERS PARTNER, RIVER, CITY RANCHES #2 LTD., LEON SHEPARD, TAX MATTERS PARTNER, RIVER CITY RANCHES #3 LTD., LEON SHEPARD, TAX MATTERS PARTNER, RIVER CITY RANCHES #4 LTD., LEON SHEPARD, TAX MATTERS PARTNER, RIVER CITY RANCHES #5 LTD., LEON SHEPARD, TAX MATTERS PARTNER, RIVER CITY RANCHES #6 LTD., LEON SHEPARD, TAX MATTERS PARTNER, ET AL., *Petitioners-Appellants,*	No. 03-73853
	T.C. Nos. 787-91, 4876-94, 9550-94, 9552-94, 9554-94, 13595-94, 13597-94, 13599-94, 382-95, 383-95, 385-95, 386-95, 14718-95, 14719-95, 14720-95, 14722-95 14724-95, 21461-95, 5196-96, 5197-96, 5198-96, 5238-96, 5239-96, 5240-96, 5241-96, 9779-96, 9780-96, 9781-96, 14038-96, 21774-96, 3304-97, 3305-97, 3306-97, 3311-97, 3749-97, 15747-98, 15748-98, 15749-98, 15750-98, 15751-98, 15752-98, 15753-98, 15754-98, 19106-98, 13250-99, 13251-99, 13256-99, 13257-99, 13258-99, 13259-99, 13260-99, 13261-99, 13262-99, 16557-99, 16563-99, 16568-99, 16570-99, 16572-99, 16574-99,
v. COMMISSIONER OF INTERNAL REVENUE, *Respondent-Appellee.*	

| 16578-99, 16581-99,
| 17125-99

OPINION

Appeal from an Order of the

United States Tax Court

Argued and Submitted

January 11, 2005—San Francisco, California

Filed March 25, 2005

Before: Myron H. Bright,* A. Wallace Tashima, and

Consuelo M. Callahan, Circuit Judges.

Opinion by Judge Bright

*The Honorable Myron H. Bright, United States Circuit Judge for the Eighth Circuit, sitting by designation.

COUNSEL

Montgomery W. Cobb, Portland, Oregon, for the petitioners-appellants.

Eileen J. O'Connor, Assistant Attorney General, Richard Farber, and Anthony T. Sheehan, Department of Justice, Appellate Section, Tax Division, Washington, D.C., for the respondent-appellee.

OPINION

BRIGHT, Circuit Judge:

Introduction

We review here an extensive opinion and judgment of the Tax Court [1] relating to the tax returns of several affiliated sheep-breeding partnerships. We affirm in part, reverse in part, and remand for further proceedings. The federal Internal Revenue Service ("IRS") issued Final Partnership Administrative Adjustments ("Adjustments") to the tax returns of nine sheep- reeding partnerships for various past tax-years. [2] The Adjustments resulted in increased tax liabilities for the individual partners, such that the partners would owe significant back-taxes, penalties, and interest if the Adjustments were valid. The appellant partnerships petitioned the Tax Court for readjustment of the partnership tax returns, and the court consolidated the cases for trial.

The partnerships claimed, first, that some of the Adjustments were invalid because the IRS filed them untimely, relying on invalid extensions of the limitations periods that governed the Adjustments. The partnerships claimed, second, that insofar as the Adjustments were valid, the partnerships were entitled to certain theft-loss deductions on the adjusted tax returns. The Tax Court denied the petitions entirely, holding that the Adjustments were all valid and that the partnerships were entitled to no

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[1] The United States Tax Court, Judge Howard A. Dawson, Jr., adopting the opinion of Special Trial Judge Stanley J. Goldberg.

[2] The partnerships are River City Ranches #1 Ltd., River City Ranches #2 Ltd., River City Ranches #3 Ltd., River City Ranches #4 Ltd., River City Ranches #5 Ltd., River City Ranches #6 Ltd., River City Ranches #7 Ltd., Ovine Genetic Technology Syndicate 1987-1, and Ovine Genetic Technology 1990.

theft-loss deductions. On the latter point, the Tax Court held that the asserted losses were not thefts from the partnerships and, in the alternative, even if they were, the partnerships could not claim the deductions for the years at issue.

On appeal, the partnerships argue that the trial of the case was flawed on three procedural points: that the Tax Court improperly denied the partnerships discovery pertinent to the years for which theft-loss deductions could be claimed; that the court improperly denied discovery pertinent to the validity of the extensions of the limitations periods within which the Adjustments could be filed; and that the court improperly rejected a stipulation of fact as to the principal place of business of the partnerships.

Further, on a substantive matter, the partnerships argue that the Tax Court erred in holding that the asserted theft-losses were not thefts from the partnerships but were only thefts from the individual partners.

As to the final issue on appeal, the partnerships and the IRS agree that the Tax Court erred in holding that it does not have jurisdiction to make factual findings concerning the validity of impositions of additional interest on back-taxes owed by the individual partners, as a penalty under 26 U.S.C. §6621(c) (repealed in 1989, but still applicable to tax years before then) for engaging in sham business transactions the sole purpose of which was to gain tax benefits.

We rule as follows: (1.) We decide that the partnerships are not entitled to additional discovery pertinent to the years for which theft-loss deductions can be claimed. (2.) We affirm the Tax Court's holding that none of the losses — if they are thefts from the partnerships — can be claimed for any of the tax-years at issue. (3.) We determine that the Tax Court did not erroneously reject any stipulation of fact. (4.) We determine that the partnerships are, however,

entitled to limited additional discovery relevant to the validity of the extensions of the limitations periods. Finally (5.), we hold that the Tax Court does have jurisdiction to make findings concerning the imposition of penalty-interest under 26 U.S.C. §6621(c).

Because we affirm the Tax Court's holding that the partnerships cannot claim the asserted theft-losses in the years at issue in any event, we do not review or make any decision concerning the Tax Court's decision that the asserted losses do not constitute thefts from the partnerships, but only from the partners.

Accordingly, we vacate the judgment of the Tax Court in these cases and remand so that the partnerships will be given some limited additional discovery relating to the validity of Adjustments issued under the contested extensions of limitations periods. The Tax Court will reconsider the validity of those Adjustments after additional discovery is allowed. Also, we remand for the Tax Court to make findings as to penalty interest.

We sketch the underlying facts below, only as they bear on the discrete issues we review.

Discussion

The Tax Court's Asserted Rejection of the Principal-Place-of-Business Stipulation

The partnerships complain that the Tax Court rejected the parties' stipulation that — as the partnerships characterize it in briefing — "the principal place of business of the partnerships was in Oregon." The partnerships urge reversal on this basis. Their contention, although not entirely clear, seems to be that in determining whether the asserted theft-losses were thefts from the partnerships, the Tax Court looked to the law of the wrong state, because it erroneously rejected the stipulation. The IRS does not respond to appellants' argument on this issue.

The partnerships' argument is meritless. In their briefs, the partnerships do not quote the stipulation at issue, which merely says that the principal place of business was in Oregon at the time the partnerships filed their petitions for readjustment. SER 24. The Tax Court did not reject this stipulation. The court's statements concerning the principal place of business related to the time at which the asserted theft-losses occurred, not the time at which the petitions were filed. There was no stipulation as to the former time.

Additionally, even had the asserted rejection of a stipulation been actual, the partnerships do not show, as they must, that it would have made any difference. *See Cerrato v. San Francisco Cmty. Coll. Dist.*, 26 F.3d 968, 974 (9th Cir. 1994) ("The harmless error standard in civil cases is whether the . . . verdict is more probably than not untainted by the error."). The partnerships do not show that any relevant law varied materially from Oregon to California or Nevada (the other relevant states). Furthermore, after commenting on the place of business of the partnerships, the Tax Court did in fact consider whether the losses in dispute constituted theft from the partnerships under Oregon law. We do not understand precisely what the partnerships complain of on this issue. In any event, the Tax Court did not erroneously reject any stipulation.

Discovery Pertinent to Theft-Loss Deductions

[1] The partnerships argue that the Tax Court denied them a fair opportunity to litigate their claim that they are entitled to theft-loss deductions for the years at issue. The Internal Revenue Code provides that a theft-loss may be deducted only for the year in which it is discovered — not the year in which the loss occurs. 26 U.S.C. §165(a). The partnerships conceded at trial that they discovered the asserted theft-losses after the years in question. They argued to the Tax Court, however, that the IRS is equitably estopped from enforcing this provision of the law to exact

money from them (or their individual partners, who pay the taxes). The partnerships argue that the court denied discovery of IRS files that they were entitled to and without which they could not make good their equitable estoppel defense.

We review a denial of discovery for abuse of discretion. *Shad v. Dean Witter Reynolds, Inc.*, 799 F.2d 525, 527 (9th Cir. 1986). We will hold an order denying discovery to be an abuse of discretion only "upon the clearest showing that denial of discovery results in actual and substantial prejudice to the complaining litigant." *Hallett v. Morgan*, 296 F.3d 732, 751 (9th Cir. 2002).

[2] The Supreme Court allows the possibility that equitable estoppel might be successfully asserted against the government — whether to get money from the government or as a defense to the government's exaction of money. *See Office of Personnel Mgmt. v. Richmond*, 496 U.S. 414, 426 (1990); *Heckler v. Cmty. Health Svcs. of Crawford County, Inc.*, 467 U.S. 51, 59-60 (1984). In general,

> the party claiming the estoppel must have relied on its adversary's conduct "in such a manner as to change his position for the worse," and that reliance must have been reasonable in that the party claiming the estoppel did not know nor should it have known that its adversary's conduct was misleading.

Id. at 59. The Court has made clear that estoppel will not lie against the government except upon a stronger showing than is required in the ordinary case. *Id.* at 59-60.

[3] As the Tax Court noted, the Ninth Circuit has held, in a case involving a taxpayer's attempt to recoup payments made to the IRS, that equitable estoppel cannot lie against the government absent a showing of "affirmative conduct going beyond mere negligence." *Purcell v. United States*, 1 F.3d 932, 939 (9th Cir. 1993).

The Tax Court found that the IRS had engaged in no conduct which the partnerships could reasonably have relied on to change their position for the worse. Even if the IRS did nothing to act as a watchdog for the individual partners, to warn them that Hoyt was swindling them and looting the partnerships, and that their claimed tax benefits were invalid, this would not constitute the "affirmative conduct" on which the partnerships could "rely" that is necessary to invoke equitable estoppel against the government. The court found, however, that the IRS had, on numerous occasions, communicated to the partnerships and to the individual partners messages that called into question the validity of tax benefits the partnerships claimed — the subsequent rejection of which, in the Adjustments, are at issue in these cases.

The partnerships do not dispute the Tax Court's specific findings as to actions taken by the IRS. The partnerships' hope and argument as to discovery on this point must be, then, that there may be other, countervailing IRS actions, evidence of which may lie in IRS files. Such IRS actions help the partnerships only if the partnerships reasonably relied on the actions and thereby discovered the asserted theft-losses later than the years in question.

In the ordinary case, if the IRS had taken actions on which the partnerships relied, the partnerships would of course know about those actions. They would not need to examine IRS files to learn of those actions in the first instance, as the partnerships here wish to do. This case is unusual, but a brief sketch of the facts shows that the result is the same.

Here, Walter J. Hoyt, III (Hoyt), ran the partnerships, which were among scores of partnerships Hoyt created as part of a massive swindle extending from 1971 (involving cattle partnerships) and 1978 (involving sheep partnerships) to 1998 — defrauding his partners, receiving (as general or managing partner) their capital contributions

to the partnerships and then stealing those contributions, and as Tax Matters Partner ("TMP") claiming phony tax benefits for the partnerships, on which his partners relied for purposes of their individual tax returns. Hoyt did not keep ordinary business records for each of his many partnerships, but kept certain overall records. Hoyt was eventually caught, and is now serving an approximately twenty-year prison sentence for fraud. The new TMPs for the partnerships, who are pursuing the present cases, thus did not inherit the records and continuous institutional knowledge that a partnership would ordinarily possess. The IRS, which had conducted a roughly twenty-year investigation of Hoyt's operations, presumably has far greater knowledge of the partnerships' matters than the current TMPs have.

Because of Hoyt's commingling of the records of his various partnerships, the IRS followed suit and maintained the bulk of its documents pertaining to all Hoyt entities in a single file, with only very limited portions of its records in files specific to individual partnerships. The Tax Court granted the partnerships discovery only of the files specific to the individual partnerships at issue here, so that the partnerships did not see the bulk of the IRS's records.

While the partnerships reasonably suppose that the IRS knows more about the partnerships than the partnerships themselves know, the discovery issue comes down to a narrow question: If the IRS engaged in affirmative conduct that the partnerships reasonably relied on, and that caused the partnerships to discover the asserted theft-losses later than they otherwise would have, would evidence of such conduct be unavailable to the partnerships now, without the discovery they were denied?[3]

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[3] The issue would be presented differently if the partnerships alleged specific conduct and sought discovery only to confirm or negate the specifics they had knowledge of already.

[4] The managing partner of each of the partnerships, Hoyt, knew about the thefts at the time they occurred, because he was the thief. The partnerships could not have detrimentally relied, through Hoyt, on IRS actions to forestall discovery of the theft. [4] If the other partners, outside of the partnership management, relied on affirmative IRS actions that forestalled their discovery of Hoyt's theft, then evidence of the actions would lie with the partners. The partnerships would thus not need the IRS's central Hoyt files. The Tax Court thus did not abuse its discretion in denying discovery related to the partnerships' equitable-estoppel argument.

[5] Because the year-of-discovery issue was properly litigated at trial, and because the partnerships admitted that they did not discover the asserted theft-losses during the years at issue, we affirm the Tax Court's holding that the partnerships cannot take the deductions in the years at issue. Our holding here makes it unnecessary to review the Tax Court's holding that the thefts at issue were not thefts from the partnerships, but only from the individual partners.

Discovery Pertinent to the Validity of the Adjustments

The IRS issued some of the Adjustments after the default limitations periods had expired. With regard to these Adjustments, however, Hoyt, acting for the partnerships, had extended the limitations periods. The partnerships argued before the Tax Court that these extensions are invalid, because Hoyt executed them while disabled by conflicts between his own interests and those of his partners. The partnerships argue on appeal that they

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[4] We do not imply that knowledge of a partner who is defrauding the partnership is imputed to the partnership. *See* Cal. Corp. Code §16102 (2005); Or. Rev. Stat. §67.010(6).

could not present this defense adequately without the denied discovery.

[6] This Court has recognized that a TMP may lack capacity to bind his partners and the partnership, where the TMP operates under a conflict of interest. *See Phillips v. Commissioner* , 272 F.3d 1172, 1175 (9th Cir. 2001) ("Trust law, generally, invalidates the transaction of a trustee who is breaching his trust in a transaction in which the other party is aware of the breach."). The Tax Court found that the partnerships did not present evidence sufficient to show that Hoyt executed the extensions under disabling conflicts of interest. The question here is whether the partnerships were entitled to discovery of the IRS's central Hoyt files, to find out the facts concerning Hoyt's interests in his dealings with the IRS, and what the IRS knew about Hoyt's interests and his treatment of the partners' interests.

The partnerships argued to the Tax Court that conflicts arose not only because of past criminal investigations of Hoyt by the IRS, but also by Hoyt's ongoing fraud and theft, committed against his partners. The partnerships argued that Hoyt's interests, specifically regarding tax issues, diverged from those of the partnerships.

[7] The Tax Court analogized this case to the *Phillips* case, 272 F.3d 1172, in which this Court held that the mere existence of past criminal investigations of a TMP does not prove a disabling conflict of interest. Here, the Tax Court emphasized that, as in *Phillips*, Hoyt was not under active criminal investigation by the IRS when he signed any of the extensions. The comparison to *Phillips* is unilluminating, however, because in *Phillips* "[t]he facts were stipulated by the parties in skeletal form sufficient to provide, without much flesh, what was necessary to raise the single issue relied on by Phillips." *Id.* at 1173. The lesson of *Phillips* is that the sole fact of past criminal investigations does not establish a disabling conflict of interest. But there is more

to the partnerships' assertion of a disabling conflict than past criminal investigations, and the record before us in this case is not a bare skeleton.

The record before us presents at least one apparent conflict which, if substantiated, might render the extensions Hoyt signed legally incompetent and void. To explain this apparent conflict, we turn again to some of the facts of record.

Hoyt signed all but one of the extensions between February 1991 and March 1993. The IRS had been investigating Hoyt, though not always by its criminal investigation division, since about 1980. The IRS became convinced that Hoyt's many partnerships were fraudulent tax shelters. This was difficult to prove, however, because of the nature of the operations.

The Hoyt entities were ostensibly livestock-breeding enterprises. The nine partnerships at issue in these cases were sheep-breeding, but the majority of Hoyt's partnerships were cattle- reeding. While Hoyt's long-running swindle was essentially a matter of taking money in exchange for cows and sheep that did not exist, the operations did have thousands of actual cows and sheep on actual ranches with actual breeding facilities run by well-known and highly respected breeders. The Hoyt ranches included twelve active ranches and half a million acres of land rented from the Federal Bureau of Land Management. It was not a simple matter, then, to prove that some of the livestock that appeared as figures on business papers had no corporeal substance on the ground.

From about 1980 the IRS, convinced that the Hoyt partnerships were shams, generally disallowed tax benefits claimed by the partnerships, leading to much litigation in the Tax Court. With many cows and sheep spread over many facilities, the IRS had difficulty proving that the partnerships were shams, and in 1989 the IRS suffered a

major setback. The Tax Court, in *Bales v. Commissioner*, T.C. Memo. 1989-568, 58 T.C.M. (CCH) 431, found that the cattle partnerships were not shams. After *Bales*, the IRS determined to conduct a full headcount of the Hoyt livestock, to attempt to prove the fraud.

A headcount could provide proof that Hoyt had been taking money for non-existent cows and sheep — for which Hoyt presumably knew he was vulnerable to criminal prosecution. Hoyt did not cooperate with the headcount. His lack of cooperation delayed the count, until finally a federal court order permitting the count was issued in the Fall of 1992. The IRS finished the headcount in the Spring of 1993.

Hoyt signed the extensions between February 1991 and March 1993 — that is, in the period when the IRS was first seeking and then performing the headcount that would prove his crimes.

[8] The extensions of the limitations periods within which the IRS could issue Adjustments may have been against the partners' interests but in Hoyt's interest. The sooner the IRS issued the Adjustments, the more difficult it would be for the IRS to defend them. Additionally, because the partners had in fact claimed tax benefits they were not entitled to, it was in their interest for the Adjustments to be issued sooner rather than later, even if the IRS could successfully defend the Adjustments. Delay would mean greater penalties and interest when eventually the back-taxes were levied. Finally, it was in the partners' interest to receive the strong indication, which the Adjustments provided, that Hoyt was looting the partnerships. The Tax Court noted that such measures by the IRS led some partners to withdraw from other partnerships and to challenge Hoyt's management of them — by means that included a civil fraud suit.

[9] Hoyt's interests appear to have run in the opposite direction — toward delaying as long as possible any threat

to the house of cards he had constructed and kept standing since 1971. The extensions he signed would, and did, forestall the issuance of Adjustments that would have contributed to tensions with his partners and threatened his management of the partnerships. Facing the threat of a potential and then an actual IRS headcount that would prove his crimes, Hoyt might well have found it in his interest to offer any concession to the IRS that did not harm him personally, in the hope that it would put off the day of reckoning — perhaps forever, if his long run of luck held out.

[10] Because the evidence in this unusual case lies largely with the IRS, the partnerships could not fairly and reasonably litigate their challenge to the extensions and the Adjustments executed pursuant to them without this discovery. The Tax Court thus abused its discretion in denying such discovery, and the partnerships suffered actual and substantial prejudice because of the denial. Accordingly, the Tax Court should permit further discovery limited to the question whether Hoyt executed the extensions while disabled by conflicts of interest.

Jurisdiction of the Tax Court to Make Penalty-Interest Findings

The parties asked the Tax Court to make factual findings concerning whether the partnerships' transactions were designed merely to secure tax benefits, without any other substantive economic purpose. The parties wanted the court to make these findings because they bear on whether the IRS can require the investor-partners to pay a higher interest rate on the back taxes for certain years. *See* 26 U.S.C. §6621(c). The Tax Court held that it lacked jurisdiction to make such findings. The parties agree that the court erred in so concluding.

Both the Tax Court's interpretation of 26 U.S.C. §6621(c) and its holding that it lacked subject-matter

jurisdiction to make findings under that statute are legal conclusions reviewable de novo. *Suzy's Zoo v. Commissioner*, 273 F.3d 875, 878 (9th Cir. 2001); *Crawford v. Commissioner*, 266 F.3d 1120, 1123 (9th Cir. 2001).

We agree with the parties that the Tax Court erred. Because the issue is somewhat involved, and the Tax Court considered the issue at length, we explain our reading of the relevant law.

The partnerships filed petitions with the Tax Court to readjust partnership tax items, following the IRS's issuance of Adjustments. This petition procedure is governed by 26 U.S.C. §6226. This section also sets the scope of review for the Tax Court reviewing the petition:

> (f) Scope of judicial review.—A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment relates, the proper allocation of such items among the partners, and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item.

The question, then, is what counts as a partnership item. The term is defined at 26 U.S.C. §6231(a)(3):

> (3) Partnership item.—The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

The Tax Court saw that the definition here is limited by the phrase "required to be taken into account . . . under . . . subtitle A."

The character of the partnerships' transactions does relate back to subtitle A, because it determines the individual partners' personal income taxes — a subtitle A matter, *see* 26 U.S.C. §1. A partnership's tax items affect not the (nonexistent) income tax of the partnerships, but the income tax of the partners. 26 U.S.C. §6222 (subtitle F provision for administering subtitle A requirements). A partnership's tax items, which determine the partners' taxes, are litigated in partnership proceedings — not in the individual partners' cases. 26 U.S.C. §6221 (subtitle F provision for administering subtitle A requirements).

[11] The nature of the partnerships' transactions is a "partnership item" then, because it is "required to be taken into account . . . under . . . [the income tax provisions of] subtitle A," as affecting the income tax of the individual partners. As a "partnership item," the character of the partnerships' transactions is within the Tax Court's scope of review.

[12] The Tax Court erred in holding that it had no jurisdiction to make findings concerning the character of the partnerships' transactions, for purposes of the 26 U.S.C. §6621 penalty-interest provisions. Accordingly, we remand for the court to make such findings.

Conclusion

For the reasons we have stated, we affirm the Tax Court's holding that these partnerships cannot claim a theft-loss deduction in the years at issue.

We vacate the judgment of the Tax Court as to all Adjustments issued pursuant to an extension of the limitations period, and remand for additional discovery on the question of whether Hoyt executed the extensions while

disabled by conflicts between his own interests and those of his partners, and any necessary retrial following such discovery. As to Adjustments executed within the default limitations periods, our ruling does not disturb the Tax Court's denial of the petitions for readjustment.[5]

We reverse the judgment of the Tax Court that the court lacks jurisdiction in this partnership-level proceeding to make factual findings pertaining to the imposition of penaltyinterest under 26 U.S.C. §6621, and we remand for the Tax Court to make such findings. Each party shall bear its own costs on appeal.

AFFIRMED in part, REVERSED in part, and REMANDED for further proceedings.

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[5] The record before us does not clearly identify which Adjustments were filed within the default limitations periods and which were filed under the disputed extensions. The Tax Court will distinguish these two classes of adjustments on remand.

United States Court of Appeals,

Fifth Circuit.

03-20174

MORRIS A. WEINER,

Plaintiff-Appellant-Cross-Appellee,

v.

UNITED STATES OF AMERICA,

Defendant-Appellee-Cross-Appellant,

Consolidated with No. 03-20176

MARION S. KRAEMER; JOYCE W. KRAEMER,

Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,

Defendant-Appellee.

Appeals from the United States District Court

for the Southern District of Texas

Before JOLLY, DAVIS and JONES, Circuit Judges.

EDITH H. JONES, Circuit Judge:

Appealing in two related cases from separate courts, Morris Weiner, Marion Kraemer, and Joyce Kraemer seek refunds of federal income taxes and interest paid in connection with their investments in various partnerships. Three issues are raised. First is the question whether federal courts have jurisdiction, notwithstanding 26 U.S.C. §7422(h), to entertain the taxpayers' complaints that Notices of Final Partnership Administrative Adjustments

(FPAAs) were untimely filed and cannot be the basis of assessments against them. Second, the taxpayers challenge substantial interest charged against them for "tax-motivated transactions" pursuant to now-repealed §6621(c). We hold that the courts lacked jurisdiction over the statute of limitations issue and that §6621(c) interest was improperly charged. The third issue was resolved by a recent decision of this court at odds with the trial courts' decisions. *See Beall v. United States,* 336 F.3d 419 (5th Cir.2003) (district courts have jurisdiction to resolve taxpayers' deficiency interest abatement requests under §6404(e)).

I. The Factual Background

In the early 1980s, the taxpayers, all high-income professionals, invested in limited partnerships organized by American Agri-Corp ("AMCOR"). Weiner was a limited partner in Travertine Flame Associates ("TFA"); Joyce Kraemer was a limited partner in Oasis Date Associates ("ODA"); and Marion Kraemer was a limited partner in Coachella Fruit Growers ("Coachella"). The partnerships were farming entities that projected tax write-offs of approximately two hundred percent of the amount invested. The taxpayers reported their proportionate share of partnership losses on their 1984, 1985, and 1986 income tax returns.

In 1990 and 1991, the Internal Revenue Service ("IRS") sent each of the partnerships a Notice of FPAA that disallowed farming expenses and other deductions for a number of reasons, including that the partnerships' transactions were "shams" and lacked economic substance. Also in 1991, partners in TFA and ODA commenced a Tax Court action challenging the adjustments as time-barred. Because Weiner and Joyce Kraemer were partners in TFA and ODA, they automatically became parties to the suit. *See* 26 U.S.C. §6226(c).

In early 1997, while the Tax Court cases were still pending, the taxpayers offered to settle their disputed partnership item deductions with the IRS through executions of Forms 870-P(AD). These settlement forms were initially sent to them by the IRS. The settlement agreement purported to disallow sixty-three percent of the deductions, as opposed to a total disallowance. The settlement documents made it clear that the IRS would assess additional tax liability and interest "as provided by law."

After accepting the taxpayers' settlements, the IRS assessed additional tax liability and interest pursuant to §6621(c) in the following manner: for Weiner in 1984 – in additional tax and $16,663.22 in interest; for the Kraemers in 1984 – $13,159 in additional tax and $16,599 in interest; for the Kraemers in 1986 – no additional tax (because they had overpaid) but $4,088 in interest. The taxpayers commenced their separate refund suits in 2000. They argued in motions for summary judgment: (1) that the statute of limitations prevented the 1984 assessments; (2) that additional interest under §6621(c) was improper as a matter of law; and (3) that the Commissioner had abused his discretion in denying their §6404(e) abatement of interest claim. The *Kraemer* court did not consider the limitations defense because it concluded it lacked subject matter jurisdiction over the issue. The *Weiner* court, however, concluded that it did have jurisdiction, and ultimately decided that the statute of limitations had not run. Both courts also determined that they lacked jurisdiction over the interest abatement claims. Both courts denied the taxpayers' summary judgment motions on the §6621(c) argument and set the issue for bench trials. The Kraemers conceded the issue before trial, but Weiner presented evidence on the merits and the court ultimately concluded that the interest was improper and ruled in Weiner's favor. The instant appeals followed.

II. The Statutory Background

This case is governed by the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), 26 U.S.C. §§6221-6233, which was enacted to "improve the auditing and adjustments of income tax items attributable to partnerships." *Alexander v. United States,* 44 F.3d 328, 330 (5th Cir.1995). TEFRA requires partnerships to file informational returns reflecting the distributive shares of income, gains, deductions, and credits attributable to its partners. *Kaplan v. United States,* 133 F.3d 469, 471 (7th Cir.1998). Accordingly, the individual partners are responsible for reporting their pro rata share of tax on their income tax returns. *Id.; see also* 26 U.S.C. §701.

TEFRA requires the treatment of all partnership items to be determined at the partnership level. 26 U.S.C. §6221. While TEFRA defines a "partnership item" in technical terms, the provision generally encompasses items "more appropriately determined at the partnership level than at the partner level." *Id.* §6231(a)(3). All other items are defined as nonpartnership items. *Id.* §6231(a)(4).

If the IRS decides to adjust any "partnership items" reflected on the partnership's return, it must notify the individual partners of the adjustment through a Notice of FPAA. *Kaplan,* 133 F.3d at 471. The IRS is given three years from the later of (1) the date a partnership return is due, or (2) the date the partnership return is filed, to issue an FPAA. 26 U.S.C. §6229(a). The three-year period may be extended by agreement (1) between the Secretary and the partnership's tax matters partner ("TMP") (which binds all partners), or (2) between the Secretary and an individual partner (which binds only that partner). *Id.* §6229(b)(1). In addition, if the IRS mails an FPAA to the TMP, the three-year period is tolled. *Id.* §6229(d). This three-year limitations period is at issue in this case.

For ninety days following issuance of an FPAA, the TMP has the exclusive right to file a petition for readjustment of the partnership items in Tax Court, the Court of Federal Claims, or a United States District Court. *Id.* §6226(a). After expiration of the ninety-day period, other partners are given sixty days to file a petition for readjustment. *Id.* §6226(b)(1). If a partner's tax liability might be affected by the outcome of the litigation of partnership items, that partner may participate in the proceeding. *Id.* §6224(a), §6224(c). The IRS may assess additional tax liability against individual partners within one year of the final conclusion of the partnership's tax determination. *Id.* §6229(d). The partner may contest the tax liability by paying the assessment and filing a refund action in a United States District Court. However, "[n]o action may be brought [in district court] for a refund attributable to partnership items." *Id.* §7422(h).

But, if a partner settles his partnership tax liability with the IRS, the partner will no longer be able to participate in the partnership level litigation, and will be bound instead by the terms of the settlement agreement. *Id.* §6228(a)(4), §6224(c)(1). In addition, partnership items convert to nonpartnership items when the IRS enters into a settlement agreement with the partner with respect to such items. *Id.* §6231(b)(1)(C). Thus, if a partner files an action for a refund attributable to partnership items, but those items have been converted through a settlement agreement, the jurisdictional bar of §7422(h) no longer applies. *Alexander v. United States,* 44 F.3d 328, 331 (5th Cir.1995).

III. FPAA Statute of Limitations

The *Weiner* and *Kraemer* courts reached opposing conclusions, and the parties disagree on whether district courts have jurisdiction to decide the FPAA statute of

limitations question in refund actions.[1] Generally, district courts have jurisdiction over a taxpayer's refund action. 28 U.S.C. §§1340, 1346(a)(1). However, as discussed above, with limited exceptions not applicable here, "[n]o action may be brought for a refund attributable to partnership items (as defined in §6231(a)(3))." 26 U.S.C. §7422(h). The more precise question in this case, then, is whether the taxpayers' refund requests are attributable to any partnership item such that the district court would be deprived of jurisdiction.

This court reviews a district court's grant of summary judgment de novo and considers the same criteria that the district court relied upon when deciding the motion. *Mongrue v. Monsanto Co.*, 249 F.3d 422, 428 (5th Cir.2001). Summary judgment is only appropriate when "the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). In addition, we review a district court's determination of subject matter jurisdiction de novo. *Calhoun County, Tex. v. United States,* 132 F.3d 1100, 1103 (5th Cir.1998).

The taxpayers' refund claims are based entirely on the theory that the IRS had no authority to assess tax against them in 1990 and 1991 because the FPAA statute of limitations had run for the years 1984 to 1986. Accordingly, to avoid the jurisdictional bar of §7422(h), the taxpayers argue that the FPAA statute of limitations, found in

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[1] The taxpayers also appeal the *Weiner* court's decision that, because the 1984 partnership returns were invalid, the statute of limitations did not begin to run. We need not reach this argument.

§6229(a), is not a "partnership item." [2] As noted before, TEFRA defines a "partnership item" as

> any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for the purposes of [subtitle F], such item is more appropriately determined at the partnership level than at the partner level.

26 U.S.C. §6231(a)(3). The taxpayers argue that because §6229(a), containing the FPAA statute of limitations provision, is found in subtitle F, as opposed to subtitle A, it is not a partnership item. Furthermore, the taxpayers argue

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[2] Although a partner's settlement agreement with the IRS converts partnership items to nonpartnership items and thereby lifts §7422(h)'s jurisdictional bar, the conversion did not occur in this case. The Code provides that only those partnership items encompassed by the settlement agreement are converted to nonpartnership items. *See* 26 U.S.C. §6231(b)(1)(C) (partnership items of a partner shall convert to nonpartnership items when "the Secretary or the Attorney General (or his delegate) enters into a settlement agreement with the partner *with respect to such items*") (emphasis added). Section 6229(a) was not mentioned in the taxpayers' settlement agreements and thus may not be considered a converted item. The holding in *Alexander* is not to the contrary. In that case, the taxpayer filed a refund action based on the IRS's admission, in a separate Tax Court proceeding, that the FPAA statute of limitations had run. 44 F.3d at 330. Because it was unnecessary for the court to determine the merits of the statute of limitations question when examining its jurisdiction to hear the refund suit, the court did not examine, as we must in this case, whether the FPAA statute of limitations was a partnership item that deprived the court of jurisdiction. Instead, the court examined the basis for its general grant of jurisdiction over the refund suit. In this regard, the court asked whether "the adjustments called for in the FPAA" were partnership items and determined that the settlement agreement, which settled those items specifically, converted them to nonpartnership items. *Alexander*, 44 F.3d at 331. Thus, the court found that it had jurisdiction to decide the *partner-specific* question of whether the taxpayer's settlement agreement *contractually* barred the refund (an issue not present in this case).

that no treasury regulation specifically refers to the limitations issue as a partnership item. *See* 26 C.F.R. §301.6231(a)(3)- 1(a). The *Weiner* court reasoned that this omission, coupled with the fact that §6229(a) is found only in subtitle F, prevents the FPAA statute of limitations from attaining partnership item status. We disagree with this conclusion.

First, the majority of courts to consider this issue have held that the FPAA statute of limitations issue is a partnership item that must be litigated in a partnership level proceeding. *See Chimblo v. Commissioner,* 177 F.3d 119, 125 (2nd Cir.1999); *Kaplan v. United States,* 133 F.3d 469, 473 (7th Cir.1998); *Williams v. United States,* 165 F.3d 30 (6th Cir.1998) (unpublished table decision); *Barnes v. United States,* No. 95-57-Civ-ORL-22, 1997 WL 732594, *3 (M.D.Fla. July 25, 1997), *aff'd,* 158 F.3d 587 (11th Cir.1998); *Thomas v. United States,* 967 F.Supp. 505, 506 (N.D.Ga.1997); *Slovacek v. United States,* 36 Fed. Cl. 250, 255 (1996). These courts have reasoned that because the FPAA limitations issue affects the partnership as a whole, it should not be litigated in an individual partner proceeding, as such a result would contravene the purposes of TEFRA. *See, e.g., Chimblo,* 177 F.3d at 125. We agree with this reasoning and hold that the district courts lack jurisdiction to consider the taxpayers' statute of limitations argument.

Second, responding to the taxpayers' argument directly, the treasury regulations provide that, for the purposes of subtitle F,

> [t]he term "partnership item" *includes* the accounting practices and the *legal and factual determinations* that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc.

26 C.F.R. §301.6231(a)(3)-1(b) (emphasis added). As the court in *Slovacek* reasoned, the statute of limitations "might be said to affect the amount, timing, and characterization of income, etc., (partnership items) at the partnership level, if only in a thumbs-up or thumbs-down manner." 36 Fed.Cl. at 255. In this way, the treasury regulations have implicitly included the statute of limitations determination within the definition of "partnership item."[3]

Third, we find distinguishable two cases the taxpayers rely on. In *Monti v. United States,* 223 F.3d 76, 82 (2nd Cir.2000), the court held that a partner's right to seek consistent settlement terms from the IRS was more appropriately considered a nonpartnership item. The Second Circuit relied on several factors to justify this conclusion, among them the fact that the right to consistent settlement terms, located in §6224(c)(2), is found in subtitle F, as opposed to subtitle A. *Id.* at 82. However, the first and arguably most important factor considered by the *Monti* court in deciding how to categorize a partner's right to consistent settlement terms dealt with the practical realities of that right. The court noted that

> [o]ne partner's right to settlement terms consistent with those granted to another partner is not a partnership item, *because* the question posed requires consideration of the relationship between one partner's situation and another's and the individual's, rather than the partnership's, communications with the IRS. The facts needed to

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[3] That the FPAA statute of limitations does not appear in subtitle A does not alone defeat this conclusion. The treasury regulations specifically provide that the term "partnership item" *includes* the legal and factual determinations underlying the amount, timing, and characterization of certain partnership items found in subtitle A. Therefore, this definition is broad enough to include in its parameters legal and factual determinations *not* specifically found in subtitle A.

> determine whether consistent terms were offered are *facts about the partner,* not facts about the partnership.

Id. at 82-83 (emphasis added). Conversely, the FPAA statute of limitations determination challenged in this case deals with facts specific to the partnership. The court need not consider the relationship between one partner and another or an individual's communications with the IRS.

Likewise, the court in *Prochorenko v. United States,* 243 F.3d 1359, 1363 (Fed.Cir.2001), relying on *Monti,* concluded that a partner's right to request consistent settlement terms was not a partnership item. That court opined that

> [w]hether or not the [taxpayers] were entitled to such a reduction is an issue that is entirely dependent on their own unique factual circumstances, and has no effect on and is not affected by the tax liability of any of the other [ ] partners. Accordingly, this is not the type of issue that is "more appropriately determined at the partnership level."

Id. at 1363 (quoting the treasury regulations). Again, the situation in this case is quite the opposite. The timeliness of an FPAA affects the IRS's ability to make adjustments to partnership items, which in turn affects all partners alike. This determination is more appropriately made at the partnership level.

From a practical perspective, a finding of jurisdiction over the statute of limitations issue would create an absurd result that contravenes TEFRA. As was the case here, partners could settle with the IRS and thus eliminate their ability to participate in and be bound by the result of any

partnership-level proceeding. But if, as here,[4] the Tax Court decided the substantive statute of limitations issue against the partnership, the settling partners could simply bring individual partner-level suits in the district courts and attempt to obtain a different ruling on the statute of limitations issue. Thus, some partners would be required to pay the assessed deficiency, while others would not. The result advocated by the taxpayers here is at odds with TEFRA's goal of consolidating decisions that affect the partnership as a whole.

Finally, the taxpayers contend that this court's decision in *Alexander* controls the determination whether the FPAA statute of limitations is a partnership or nonpartnership item. In *Alexander*, the taxpayer received an FPAA from the IRS notifying him of an adjustment to partnership items that would affect his tax liability. 44 F.3d at 329. The taxpayer and the IRS eventually entered into a settlement agreement binding the taxpayer to the IRS's treatment of the partnership items. *Id.* at 330. Over a year after making his deficiency payment, however, the taxpayer learned that another partner had challenged the IRS's FPAA adjustments in Tax Court on the basis of the statute of limitations. *Id.* In that proceeding, the IRS conceded that the statute of limitations had expired, and the court entered judgment for the partners. *Id.* Because Alexander had already settled with the IRS, however, the result in the Tax Court did not apply to him. *See* 26 U.S.C. §6231(b)(1)(c). As a result, he filed his own individual refund action in the district court. The Government defended the suit by arguing that the parties' contractual settlement agreement

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[4] The TMP for TFA and ODA stipulated during the Tax Court litigation that those partnerships' limitations arguments would be governed by the decision in what became known as *Agri-Cal Venture Associates*, 80 T.C.M. (CCH) 295 (2000). TFA and ODA thus became bound by the Tax Court's adverse statute of limitations decision.

prevented the taxpayer from bringing any suit for refund. 44 F.3d at 330.

A panel of this court addressed its jurisdiction to determine if the settlement agreement barred the refund suit. This court first noted that §7422(h) bars suits for refunds that are "attributable to partnership items." *Id.* at 331. The question then became whether the taxpayer's refund suit was in fact "attributable to" any partnership item. The court noted that while the refund was "at one time attributable to partnership items, that is, to the adjustments called for in the FPAA," the nature of those items was altered by the settlement. *Id.* Section 6231(b)(1)(C) provides that

> [f]or purposes of this subchapter, the partnership items of a partner ... shall become nonpartnership items as of the date ... the Secretary or the Attorney General (or his delegate) enters into a settlement agreement with the partner with respect to such items[.]

Therefore, the settlement agreement converted the partnership items to nonpartnership items for the purpose of the district court's jurisdiction.[5] The taxpayers argue here that this analysis comports with their jurisdictional argument and thus excepts their case from §7422(h)'s bar.

However, the *Alexander* court did not address the question whether the court had jurisdiction to consider the *substantive* statute of limitations issue. In *Alexander,* as opposed to this case, the Government *conceded* that the statute of limitations barred the assessments. Thus, once the *Alexander* court found that it had jurisdiction generally over the refund suit, the only substantive issue left to be decided was whether the settlement agreement

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[5] As discussed *supra* in note 1, conversion does not provide a basis for jurisdiction in this case.

contractually barred the suit. *Id.* at 331-32. The settlement agreement in *Alexander,* like the one in this case, required the taxpayers to agree that they would not bring any claim for refund based on the changed treatment of the partnership items. *Id.* at 330. The court held that the contractual provision did not bar the refund suit because the taxpayer "[did] not base his refund on the treatment of partnership items at all, but rather on the time-barred deficiency assessed as a result of such treatment." *Id.* at 332. The taxpayers here seize on this language as proof that the statute of limitations question is a nonpartnership issue. However, the *Alexander* court made this statement only in the context of analyzing the *contractual* settlement agreement. The *Alexander* court did not decide whether it had jurisdiction to reach the merits of the statute of limitations argument, because that argument had already been conceded. Thus, *Alexander* does not control the question presented in this case, and this court remains convinced that the district courts lack jurisdiction to decide the FPAA statute of limitations issue. On this issue, the decision of the district court in *Weiner* is therefore incorrect, while the *Kraemer* decision is correct.

IV. 6621(c) Increased Interest

Despite its repeal in 1989, the draconian interest provision enacted as §6221(c) continues to dog taxpayers for returns filed during the early 1980s. Consequently, these taxpayers contest the Government's imposition of additional interest pursuant to 26 U.S.C. §6621(c). [6] The provision imposes an interest rate of 120% of the statutory rate on

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[6] The Kraemers suffered an adverse judgment on this point, while Weiner prevailed on the court's finding that he had a profit motive relevant to the assessment of §6221(c) interest. We do not reach the issue the district court found dispositive. Defending against the Government's appeal, however, Weiner makes, inter alia, the same argument as the Kraemers.

"any substantial underpayment attributable to tax motivated transactions."[7] 26 U.S.C. §6621(c)(1) (1988). A "substantial underpayment" is any underpayment exceeding $1,000 per tax year. *Id.* §6621(c)(2). Included in the statutory definition of "tax motivated transaction" is "any sham or fraudulent transaction." *Id.* §6621(c)(3)(A)(v).

The taxpayers contend that the trial courts are precluded from upholding the §6621(c) interest assessment because their underlying settlement agreements do not establish that their underpayments were attributable to "tax motivated transactions." In the FPAAs, the Government asserted *several* bases for the disallowance of certain deductions. Among them was a "sham or fraudulent transaction," which qualifies as a "tax motivated transaction" for the purposes of 6621(c). 26 U.S.C. §6621(c)(3)(A)(v). Because the taxpayers settled with the IRS, however, there was never any need for a court to examine the IRS's claimed bases for disallowance and make a determination about their application.

The taxpayers principally rely on *Todd v. Commissioner,* 862 F.2d 540 (5th Cir.1988). *Todd* dealt with the IRS's imposition of the §6659(a) penalty. However, because both sections employ the same "attributable to" language, the analysis in *Todd* is instructive in the §6621(c) context. In *Todd,* this court held that the taxpayers' underpayment was not "attributable to" a valuation overstatement and thus §6659(a)'s penalty did not apply. The taxpayers in *Todd* did not settle with the IRS but instead chose to challenge the IRS's disallowances in the Tax Court. In that proceeding, the Tax Court held that the Todds were not entitled to their deductions and tax credits because the assets had not been put into service during the tax year. *Id.* at 541. On appeal, this court reasoned that because the deductions and credits

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[7] This section was repealed in 1989, but it applies to the tax years in question in this appeal (1984 to 1986).

were disallowed for a reason totally unrelated to any valuation overstatement, the resulting underpayment could not be "attributable to a valuation overstatement." *Id.* at 542.

The court then applied a treasury regulation formula that determines the portion of deductions to which the higher interest rate applies.[8] Because the court had already determined that no portion of the disallowed deductions and credits were "attributable to" the valuation overstatement,

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[8] The formula for determining the amount of underpayment attributable to a valuation overstatement is as follows:

> (1) "actual tax liability" (*i.e.*, the tax liability that results from applying all of the IRS's proper adjustments) with
>
> (2) the "actual tax liability" reduced by the valuation overstatement adjustment.

The difference between (1) and (2) is the amount of the underpayment attributable to the valuation overstatement. *See Todd*, 862 F.2d at 542- 43.

Similarly, the amount of *tax motivated underpayment* for §6621(c) is determined in the following manner:

> (1) Calculate the amount of the tax liability for the taxable year as if all items of income, gain, loss, deduction, or credit, had been reported properly on the income tax return of the taxpayer ("total tax liability"); and
>
> (2) Without taking into account any adjustments to items of income, gain, loss, deduction, or credit that are attributable to tax motivated transactions ..., calculate the amount of the tax liability for the taxable year as if all other items of income, gain, loss, deduction, or credit had been reported properly on the income tax return of the taxpayer ("tax liability without regard to tax motivated transactions").

The difference between (1) and (2) is the amount of the tax motivated underpayment. *See* 26 C.F.R. §301.6221-2T, A-5.

the two sides of the equation were equal.[9] The court noted that "where the deductions and credits ... were inappropriate altogether, the Todds' valuation of the property supposedly generating the tax benefits had no impact whatsoever on the amount of tax actually owed." *Id.* at 543. Or, stated another way, the Todds' underpayment was not "attributable to" a valuation overstatement.

In *McCrary v. Commissioner,* 92 T.C. 827, 1989 WL 35568 (1989), a case also heavily relied on by the taxpayers, the Tax Court adopted the reasoning in *Todd* and concluded that the McCrarys were not subject to §6659(a) or §6621(c) interest on the disallowed investment tax credit. The McCrarys conceded one of the IRS's grounds for disallowing the investment tax credit, thus eliminating the need for a trial on these issues in the Tax Court. *Id.* at 851. The ground conceded by the McCrarys (that their agreement was a license and not a lease) was neither a "valuation overstatement" nor a "tax motivated transaction." The Tax Court noted that alternative grounds could have justified the disallowance, including sham transaction, which would have qualified for the §6621(c) addition to tax. However, the Tax Court declined to address the sham transaction issue, which was unnecessary to support the conceded disallowance, for the sole purpose of applying §6621(c). *Id.* at 859.

The taxpayers also rely on *Heasley v. Commissioner,* 902 F.2d 380 (5th Cir.1990), in which this court relied on and extended the *Todd* rule. In *Heasley,* the IRS relied on a variety of reasons for disallowing the Heasleys' claimed tax

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[9] This is because the formula requires the court to determine the portion of underpayment attributable to a valuation overstatement "after taking into account any other *proper* adjustments to tax liability." *Todd,* 862 F 2d at 542 (emphasis added). Therefore, because the Tax Court determined that not placing the assets in service was a "proper adjustment," the two sides of the formula were equal.

credits. The Heasleys, like the taxpayers here, conceded the deficiency, but continued their suit in the Tax Court to challenge the §6659(a) and §6621(c) additions to tax. The Tax Court concluded that the Heasleys' underpayment was "attributable to" a valuation overstatement under §6659(a). The Fifth Circuit reversed. With regard to §6659(a), this court held that even though the Tax Court specifically found that the underpayment was "attributable to" a valuation overstatement, a situation that differed from that in *Todd,*

> [w]henever the IRS totally disallows a deduction or credit, the IRS may not penalize the taxpayer for a valuation overstatement included in that deduction or credit. In such a case, the underpayment is not attributable to a valuation overstatement. Instead, it is attributable to claiming an improper deduction or credit.

Heasley, 902 F.2d at 383.

These cases afford a conceptual lens through which to view the statutory phrase "attributable to" in the context of §6621(c). In *Todd,* the Government argued that "attributable to" really meant "capable of being attributed," such that any time a taxpayer's underpayment was capable of being attributed to a valuation overstatement, the penalty would apply. 862 F.2d at 542. However, the *Todd* court reasoned that the formula indicated that Congress did not intend for the penalty to apply *every* time valuation overstatement was at issue. Likewise, the §6621(c) formula, *supra,* determines the amount of tax motivated underpayment by *first* taking into account any other proper, but *non-tax-motivated,* deductions. On a theoretical level, the formula provides the same reinforcement for viewing

"attributable to" *narrowly* in the §6621(c) context.[10] When so viewed, it follows that when the FPAA lists several *independent* reasons for disallowing the taxpayers' deductions, there is no way to determine, without additional superfluous litigation, whether the taxpayers' underpayment is "attributable to" a reason that also qualifies as a tax-motivated transaction (such as a sham).

The Tax Court has twice embraced this narrow view of "attributable to" in §6621(c) cases and decided that a taxpayer's blanket concession precludes a finding that any underpayment is "attributable to" a tax motivated transaction. First, in *Rogers v. Commissioner,* 60 T.C.M. (CCH) 1386 (1990), the taxpayers conceded the IRS's ability to disallow deductions. The Tax Court relied on *McCrary, supra,* and reasoned that because "the determination of whether there was a tax-motivated transaction was made only concerning the disputes over the additions to tax and increased interest, we could not conclude that the taxpayer

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[10] The Second Circuit rejected this approach and instead adopted the "capable of being attributed" definition in the §6621(c) context. *See Irom v. Commissioner,* 866 F.2d 545, 547 (2nd Cir.1989). In distinguishing *Todd,* the Second Circuit announced a "separability" test: if two grounds for deficiency exist, one of which qualifies as a tax motivated transaction and the other of which does not, and the two grounds are "inseparable," then the formula relied upon in *Todd* does not apply. *Id.* at 547-48. This court in *Heasley,* again relying on *Todd* and the formula, noted *Irom* as contrary authority only. 902 F.2d at 383 n. 5. This represents this circuit's only acknowledgment of the *Irom* rule.

However, even if the *Irom* rule were to apply, the reasons listed by the IRS in the FPAA are "separable." For example, in addition to sham transaction, the FPAA listed as reasons for disallowing the deductions the following, inter alia: (1) the partnership did not actively engage in the trade or business of farming, and (2) the partnership expenses paid or incurred were not ordinary and necessary trade or business expenses deductible under §162. The Tax Court has found that both of these reasons are "separable" from a finding of sham or fraudulent transaction. *Harris v. Commissioner,* 58 T.C.M. (CCH) 1441 (1990).

required a trial that otherwise would have been unnecessary." *Id.* at 1397. The taxpayers also cite *Schachter v. Commissioner,* 67 T.C.M. (CCH) 3092, 1994 WL 263329, *5 (1994), in which the court noted that because the taxpayer entered into a stipulation of settled issues and conceded the disallowance of deductions, these actions "obviated the need for a trial on the numerous issues raised in the deficiency notice for the purpose of identifying which, if any of them, provided the substantive ground or grounds for disallowance...." The *Schachter* court was also persuaded that because of the numerous grounds alleged in the notice of deficiency, it was impossible to say that the underpayment was "attributable to" any one ground. The court noted:

> Here, as in [*McCrary*] and [*Rogers*], the melange of alleged grounds, some of which were "tax motivated" grounds – but others were not – prevent us from saying, after the concession, that the underpayment was attributable to a particular ground. We are not inclined, in these circumstances, to rely on petitioners' burden of proof to show that the transaction was not tax motivated, all or in part, for the purpose of section 6621(c). The objectives of administrative efficiency and judicial economy have been well served by the closing agreement and petitioner's concession. Those objectives would not be served by requiring a trial on the substantive issues for the sole purpose of determining whether petitioner is liable for 20 percent more interest on the deficiency under section 6621(c).

Id. at *6.

The same situation is present in these cases: the taxpayers settled or conceded the disallowances and paid the delinquent taxes, thus removing the need for a trial on the merits of those issues. This court can conceive of no good reason to treat the taxpayers in this case differently

from the taxpayers in *Todd, McCrary, Heasley, Rogers*, or *Schachter*. There is no way, given the multiple reasons provided for the disallowance in the FPAAs, to determine whether the underpayments are "attributable to" a tax motivated transaction. Additionally, §6621(c) was one of the provisions enacted by Congress "to deal with the Tax Court backlog." *Todd,* 862 F.2d at 544 n. 14. Yet, fifteen years after the statute's repeal, imposing the penalty in situations such as this does nothing to relieve the Tax Court's backlog, when the taxpayers have in fact settled with the IRS. Because, under the circumstances of these cases, the taxpayers' underpayments are not "attributable to" a tax motivated transaction as a matter of law, the IRS may not assess the additional interest against them. We thus endorse the result in *Weiner,* albeit on different grounds, but reverse that in *Kraemer*.

Conclusion

For the foregoing reasons, we conclude that the district courts lack jurisdiction to consider the taxpayers' FPAA statute of limitations arguments. Further, §6621(c) interest cannot be assessed against the taxpayers as a matter of law. Finally, pursuant to *Beall,* the district courts have jurisdiction to consider the taxpayers' §6404(e) interest abatement claims. Accordingly, the judgments of the trial courts are

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED FOR FURTHER PROCEEDINGS.

United States Court of Appeals

for the Sixth Circuit

Myron BARLOW and Arlene Barlow,

Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

No. 01-1161

Argued May 1, 2002.

Decided and Filed Aug. 21, 2002.

Neal Nusholtz (argued and briefed), Noveck & Nusholtz, Bingham Farms, MI, for Petitioners-Appellants.

Bruce R. Ellisen (briefed), Laurie Snyder (argued and briefed), United States Department of Justice, Appellate Section Tax Division, Washington, D.C., for Respondent-Appellee.

Before SILER and CLAY, Circuit Judges; OBERDORFER, District Judge. [FN*]

FN* The Honorable Louis F. Oberdorfer, United States District Judge for the District of Columbia, sitting by designation.

OPINION

CLAY, Circuit Judge.

Petitioners, Myron Barlow and his wife Arlene Barlow, appeal from the orders entered by the United States Tax Court on November 22, 2000, for Tax Court docket numbers 6393-95 and 6394-95, and from the orders entered on December 11, 2000, for Tax Court docket numbers 4651-95 and 4652-95, in these four tax cases consolidated for purposes of appeal. This case is one in a series of cases, involving these and other taxpayers, to appear before the Tax Court regarding limited partnership tax shelters that claimed tax benefits attributable to sham transactions with respect to machines designed to recycle plastic scrap material into pellets. On appeal, Petitioners challenge the Tax Court's ruling finding them liable for negligence and a tax-motivated interest penalty. For the reasons set forth below, we **AFFIRM** the Tax Court's orders.

BACKGROUND

Procedural History

Petitioners claimed losses on their income tax returns for 1982-1985, and investment and energy credits on their 1982 return, based upon an investment made in 1982 in a plastics recycling limited partnership tax shelter known as Dickinson Recycling Associates ("Dickinson"). In September of 1988, Petitioners amended the returns in order to satisfy anticipated underpayments of tax attributable to the losses and credits they claimed in connection with the tax shelter. It is undisputed that the partnership transactions underlying the claimed tax benefits were shams, that the value of the plastic recycling machines was overstated for tax purposes, and that, as a result, until Petitioners filed the amended returns, they had underpaid their taxes for 1982-1985.

The Commissioner of Internal Revenue ("the Commissioner") issued Petitioners notices of deficiency asserting additions to tax for negligence for all four years (1982-1985), in the respective amounts of $4,829, $49, $22, and $25 (Internal Revenue Code ("IRC") § 6653(a)(1)), plus fifty percent of the interest due on the portions of the underpayments attributable to negligence (IRC § 6653(a)(2)), and an addition to tax for valuation overstatement (IRC § 6659) for 1982. The Commissioner also charged Petitioners $27,914 in interest on the 1982 underpayment, as computed at the increased interest rate mandated by IRC § 6621(c) for underpayments attributable to tax-motivated transactions. Petitioners paid the § 6621(c) interest before commencing these proceedings.

In the Tax Court, Petitioners disputed the additions to tax for negligence on factual grounds, and sought a refund of the § 6621(c) interest they had paid for 1982 on procedural grounds. Petitioners did not dispute that they were liable for the addition to tax under IRC § 6659 for 1982, nor did they dispute that the underpayment for 1982 was attributable to a tax-motivated transaction. Although the facts were largely stipulated, a trial was held with respect to the negligence issue. Two witnesses testified at trial, Petitioner Myron Barlow, and Fred Gordon, the promoter of the Dickinson tax shelter.

The Tax Court issued an opinion sustaining the Commissioner's position in all respects. The Tax Court accordingly entered decisions finding that Petitioners were liable for all of the asserted additions to tax for the years 1982-1985, and denied their claims for a refund of the interest paid for 1982. This appeal ensued.

Facts

In December of 1982, Myron Barlow (hereinafter "Barlow") invested $50,000 in the Dickinson tax shelter which was one of the limited partnership tax shelters that claimed tax benefits attributable to sham transactions involving machines designed to recycle plastic scrap material into pellets. Prior to 1982, Barlow received a bachelor's degree from Johns Hopkins University, a medical degree from the University of Michigan School of Medicine, and three years of specialized medical training in dermatology from Wayne State University. During the years at issue, Barlow practiced medicine as an employee of a professional corporation, earning salaries of $294,263 in 1982; $348,630 in 1983; $250,000 in 1984; and $356,590 in 1985. Prior to investing in the Dickinson tax shelter, Barlow had invested in a variety of property, including stocks and bonds, real estate, a partnership that invested in real estate, a coal mining company, and a communications system that he rented to a medical clinic.

Barlow was introduced to the Dickinson tax shelter in November of 1982 by Herbert Krickstein, a friend and medical colleague, and Fred Gordon, an attorney, while on a golf vacation in Florida. Gordon was actively engaged in promoting investments in Dickinson, and received a commission from Dickinson on each sale. After returning home from the golf trip in 1982, Barlow received a copy of Dickinson's private offering memorandum from Gordon in the mail, in which 18 units in Dickinson was offered at $50,000 each. The offering warned the potential investor in bold capital letters that "**THIS OFFERING INVOLVES A HIGH DEGREE OF RISK, See *CERTAIN BUSINESS RISKS and CERTAIN TAX RISKS AND CONSEQUENCES.***" (J.A. at 124.) In addition, the offering provided that "AN INVESTMENT IN THE PARTNERSHIP INVOLVES A HIGH DEGREE OF BUSINESS AND TAX RISKS AND SHOULD, THEREFORE, BE CONSIDERED

ONLY BY PERSONS WHO HAVE A SUBSTANTIAL NET WORTH AND SUBSTANTIAL PRESENT AND ANTICIPATED INCOME AND WHO CAN AFFORD TO LOSE ALL OF THEIR CASH INVESTMENT AND ALL OR A PORTION OF THEIR ANTICIPATED TAX BENEFITS." (J.A. at 125.)

The offering reported other business and tax risks such as a "substantial likelihood" of an Internal Revenue Service ("IRS") audit of the partnership and each individual partner; the partnership had no operating history; the limited partners had no control over the business and the business was dependent upon the general partner; and there was no established market for the recyclers, as well as other warnings. (J.A. at 131-36.) However, the offering also included as an attachment a copy of a favorable tax opinion prepared by the law firm of Boylan & Evans and addressed to Sam Winer, Dickinson's general partner. In discussing the recyclers' value, upon which the amount of the investment and energy tax credits depended, Boyan & Evans did not proffer its own valuation, but referred to the report of one of the evaluators. Boyan & Evans stated that their opinion as to the offering was for the general partner's "individual guidance" and that "no prospective purchaser is entitled to rely upon this letter." (J.A. at 187.)

The offering also included the opinions of two evaluators, both of whom owned interests in partnerships that leased the recyclers at issue. One of the opinions was that of Stanley N. Ulanoff, professor of marketing at the City University of New York and the author of books on technical and marketing subjects. Although Ulanoff concluded that the price for the recyclers was fair and reasonable, he did not cite that price in his report and appeared to be unaware of it. The other opinion, made by Samuel D. Burstein, an associate professor of mathematics

at New York University, did not purport to appraise the recyclers, but simply concluded that they would be operationally reliable and capable of continuously recycling polyethylene.

Barlow "browsed" through the offering memorandum, but did not read it cover to cover. Rather, he consulted with Philip Nusholtz, an attorney with whom he had a long-standing professional relationship, and whose judgment he respected and advice he valued [1]. Nusholtz also did not read the offering; however, he advised Barlow not to invest in any promotion marketed by Gordon, and to focus on more conservative investments.

Barlow then took the offering to his accountant and tax return preparer, Gerald Kabeck. Kabeck read through the offering and told Barlow that he thought that the investment was reasonable. At that time, Kabeck had no specialized knowledge or experience in plastics materials or plastics recycling and no specialized knowledge in valuing plastics recycling machines such as those in question. Barlow did not pay Kabeck for his advice.

In December of 1982, Barlow filled out and signed a subscription agreement and purchased one limited partnership unit (a 5.5% interest) in Dickinson for $50,000. A section of the agreement entitled "Purchaser's Representative(s)" stated that "[t]he undersigned understands that said Representative[s] may be compensated (to the extent of 10% of the price of the Units purchased) out of the proceeds of the offering, and, accordingly, said Representative(s) may have an interest in seeing the Offering consummated." (J.A. at 237.) In signing

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[1] Philip Nusholtz was the father of Petitioners' counsel in the matter at hand, Neal Nusholtz. (J.A. at 259.)

the agreement, Barlow claims that he assumed that the purchaser's representative referred to in this section was Gordon.

Before signing the subscription agreement and investing in Dickinson, Barlow did not make any independent investigation of the fair market value of the recycler, nor did he seek the advice of any expert in the plastics industry. Instead, Barlow was influenced to sign the agreement because he assumed that Krickstein and other medical colleagues were investing in Dickinson. Barlow, however, did not have any specific conversations with his colleagues about either Dickinson or plastics recycling before making the investment. Barlow did not believe, nor is there any evidence in the record to suggest, that Barlow's colleagues had any knowledge in plastics recycling; Barlow himself did not have any such knowledge. However, Barlow did know at the time of signing the agreement that he would receive immediate tax benefits in excess of his $50,000 investment.

Based on his initial and only investment of $50,000 in Dickinson, Barlow claimed on his 1982 tax return investment and energy credits of $77,001, which were promised in the offering, and a loss of $39,155. These claims reduced Petitioners' tax liability by $96,583, an amount that exceeded his investment by almost two to one. In addition, Barlow claimed partnership losses on Petitioners' returns for 1983 through 1985 in the respective amounts of $1,961, $866, and $1,014. Barlow never made a profit in any year from his investment in Dickinson.

Sometime in the mid-1980s, Barlow became concerned about his participation in Dickinson. In September of 1988, Barlow amended his returns for 1982 through 1985 in order to satisfy anticipated underpayments of tax attributable to the Dickinson investment.

Dickinson was a so-called "TEFRA" partnership subject to the unified partnership audit and litigation procedures set forth in IRC §§ 6221-6233. On May 15, 1989, the Commissioner mailed a Notice of Final Partnership Administrative ("FPAA") to Sam Winer, the tax matters partner of the Dickinson partnership, for each of the taxable years 1982-1985. A copy of each FPAA was also mailed to Barlow.

The FPAAs advised Barlow of adjustments that the Commissioner proposed to make to the partnership returns filed by Dickinson. Specifically, the FPAAs disallowed deductions and credits claimed by Dickinson in connection with its plastics recycling activities for 1982 through 1985. On June 12, 1989, Sam Winer petitioned the Tax Court with respect to the FPAA, commencing the case of *Dickinson Recycling Associates v. Commissioner*. While that case was pending, the Tax Court, in 1992, decided that the plastics recycling transaction involved in *Provizer v. Commissioner,* 63 T.C. 2531, (1992) were shams, and this Court affirmed in an unpublished decision. *See* 996 F.2d 1216 (6th Cir.1993). Winer, who was also the tax matters partner of the partnership involved in *Provizer,* conceded in *Dickinson* that the Commissioner had correctly disallowed all items of income, loss, and credit, and that the recyclers were overvalued. Accordingly, on February 23, 1994, the Tax Court entered its decision in *Dickinson* sustaining the Commissioner's FPAA determinations for 1982-85.

On November 18, 1994, after the Tax Court's decision in the *Dickinson* partnership-level proceeding became final, the Commissioner mailed a letter to Petitioners in connection with the 1982 tax year, advising them that 1) their 1982 amended return had been accepted as filed; 2) their $96,583 underpayment was attributable to a tax-motivated transaction; and 3) as a result, IRC § 6621(c) interest was

applicable. Section 6621(c) provides for an increased rate of interest with respect to underpayments attributable to a tax-motivated transaction. *See* 26 U.S.C. § 6621(c). The Commissioner notified Petitioners on December 12, 1994, that the amount of interest assessed against them under § 6621(c) was $27,914. Petitioners paid the interest later that month.

Thereafter, in March of 1995, the Commissioner sent Petitioners notices of deficiencies for each of the years 1982-1985, determining that Petitioners were liable for additions to tax for negligence. The Commissioner also determined that Petitioners were liable for another addition to tax for 1982 for overstating the value of the recycling machines. Petitioners took their case to the Tax Court, challenging only the additions to tax for negligence and the § 6621(c) interest for 1982. Trial was held in connection with the negligence issue, wherein two witnesses testified. Barlow was one of the witnesses to testify, stating that he received advice about investing in Dickinson, and Gordon testified as to his role in promoting the Dickinson investment. With respect to the § 6621(c) issue, Barlow did not dispute that the underpayment for 1982 was attributable to a tax-motivated transaction, but, instead, claimed that because no court would have jurisdiction to review his liability for the interest before it was paid, the imposition of the § 6621(c) interest violated due process requirements of the Fifth Amendment.

The Tax Court issued an opinion upholding the Commissioner. With respect to the negligence additions, the Tax Court opined that in light of various signs indicating that the leasing transactions were invalid and that the recycling machines were overvalued, a reasonably prudent person with Barlow's education and investment experience would have made an independent investigation

into the validity of the investment, which Barlow failed to do. With respect to the § 6621(c) interest issue, the Tax Court recognized that in cases such as this, where tax-motivated interest is assessed on an underpayment that is attributable to a partnership transaction that is tax-motivated, a prepayment judicial determination as to the amount of the taxpayer's liability for such interest is unavailable to the taxpayer. The Tax Court held that this fact did not violate due process inasmuch as there were judicial forums, including the Tax Court, in which Petitioners could seek judicial review of this assessment after it had been paid, and Petitioners have availed themselves of the forums.

DISCUSSION

I. Whether the Tax Court Acted Without Jurisdiction in Finding Statutory and Constitutional Authority for the Assessment of Interest under 1954 IRC § 6621.

This Court reviews *de novo* the Tax Court's legal conclusions made based upon its findings of fact. *See Smith v. Commissioner,* 937 F.2d 1089, 1096 (6th Cir.1991).

Petitioners argue that not all tax assessments may be made without notice and opportunity for a hearing, and claim that the denial of a pre-assessment hearing denied them due process. Petitioners also make several circular arguments claiming such things as inconsistencies in the tax code regarding Tax Court jurisdiction, and that the legislative history of § 6621(a) suggests that the tax-motivated interest penalty was intended to be part of Tax Court proceedings when, in 1984, Congress instructed the Tax Court to issue various penalties, including § 6621(c) to reduce its enormous workload due to tax shelters.

Petitioners suggest, "[h]ow would the Tax Court use the tax motivated interest penalty to lighten its docket if it was not intended to have jurisdiction over it in the first place? The greatest likelihood is that if Congress had intended assessments of tax motivated interest to be done without the benefit of notice of deficiency, it would have done so directly, as it had done on previous occasions." Petitioners conclude that "[i]f the tax motivated interest penalty is not interest and subject to Tax Court jurisdiction under IRC § 6621(c)(4), then the assessment has been made without specific statutory authority. Such assessments are void as a denial of due process." *See* Petitioners' Brief on Appeal at 16.

The Commissioner argues that Petitioners' due process argument based upon the Tax Court's jurisdiction-or lack thereof-to review the imposition of interest at the rate set forth in IRC § 6621(c) is without merit. The Commissioner maintains that pursuant to IRC §§ 6213 and 7442, the Tax Court has jurisdiction to redetermine a "deficiency," as that term is defined in § 6211. The Commissioner further maintains that where the Tax Court has deficiency jurisdiction over a particular tax year, then pursuant to IRC § 6512(b), the Tax Court has jurisdiction to review a taxpayer's claim that there has been an overpayment with respect to that year. And although a taxpayer must first pay the amount in dispute, he may contest his tax liability by way of a refund suit in the appropriate district court or in the Court of Federal Claims under 28 U.S.C. §§ 1346(a)(1) & 1491(a)(1). We agree with the Commissioner's argument in all respects.

In *White v. Commissioner,* 95 T.C. 209, 210, 1990 WL 125093 (1990), the Commissioner issued a notice of deficiency to the petitioners after a partnership-level proceeding was completed determining that the petitioners

were liable for additional interest under IRC § 6621(c), as well as additions to tax under IRC §§ 6651(a)(1), 6653(a)(1), 6653(a)(2) and 6659. The petitioners filed a petition for redetermination, and the Commissioner filed a motion to dismiss for lack of jurisdiction as to the petitioner's claims regarding liability for interest under § 6621(c). *Id.* The Tax Court examined its statutory grant of jurisdiction to review matters regarding the imposition of § 6621(c) interest on an underpayment attributable to a partnership transaction when the matter is brought by an individual taxpayer-partner. *Id.* at 211-13. The Tax Court held that it had no jurisdiction to review the matter because under IRC § 6621(a), 6230(a), and 6601(e)(1), interest computed at the increased rate prescribed by § 6621(c) does not constitute a "deficiency" within the meaning of section 6621. *Id.* at 213-14. The Tax Court reasoned that, in general, a partnership's items of income, deduction, loss, and credit are determined at the partnership level, and the Tax Court has jurisdiction to review the Commissioner's determinations with respect to such matters in a partnership-level proceeding brought by the tax matters partner under IRC § 6626(a). In addition, the Tax Court found that it had jurisdiction to determine any "deficiency" attributable to affected items that require partner-level determinations brought by a taxpayer-partner with respect to his own tax liability pursuant to IRC §§ 6230(a)(2)(A) and 6231(a)(5). The court opined that "deficiency" as defined by § 6211(a), is the amount by which the tax imposed exceeds the amount paid. The Tax Court noted, however, that IRC § 6601(e)(1) specifically excludes § 6601(a) interest from the definition of tax for purposes of deficiency proceedings. *Id.* The Tax Court therefore determined that the interest due was not a "deficiency," and as a result the Tax Court did not have jurisdiction to redetermine the assessed amount. *Id.* at 213-17. Specifically, the Tax Court opined that "this Court does not have jurisdiction under section 6621(c)(4) in

the setting presented in this case to determine whether additional interest applies because the deficiency before the Court is not a substantial underpayment attributable to tax-motivated transactions." *Id.* at 216-17.

About one year later, in *Barton v. Commissioner,* 97 T.C. 548, 1991 WL 238311 (1991), the Tax Court carved out a narrow exception to the rule expounded in *White*. In *Barton,* the Tax Court held that it had jurisdiction to consider a challenge to a § 6621(c) interest assessment brought by a taxpayer-partner with respect to his own tax liability as a result of a partnership-level proceeding if the taxpayer-petitioner had paid the interest and the Tax Court otherwise had jurisdiction over the year involved. *Id.* at 551-53. The Tax Court reasoned that once the interest had been paid, it could be considered an overpayment, and the Tax Court had jurisdiction to determine whether there was an overpayment pursuant to § 6512(b). *Id.* The Tax Court distinguished *White* on the basis that the issue there did not involve an overpayment, opining as follows:

> Respondent [Commissioner] argues that since this Court does not have jurisdiction over section 6621(c) interest as a "deficiency," we cannot have jurisdiction over such interest as an "overpayment." Respondent's only authority for this proposition is *White v. Commissioner, supra* . However, as explained above, *White* held that section 6601(c) prohibits the treatment of interest as tax for purposes of our deficiency jurisdiction. No such restriction exists with respect to our jurisdiction to determine an overpayment. Likewise, our holding in *White* that we had no jurisdiction pursuant to section 6621(c)(4), because the section 6621(c) interest in *White* was not based on a deficiency over which the Court had jurisdiction, was predicated on

> a reading of the provisions of section 6621(c)(4). As previously discussed, the provisions governing overpayment jurisdiction lead to a different result.
>
> Accordingly, we hold that in the exercise of our jurisdiction to determine whether an overpayment exists and the amount of any such overpayment, we may determine petitioners' liability for increased interest under section 6621(c).

Barton, 97 T.C. at 554-55 (footnotes and citation omitted).

In the matter at hand, Petitioners argue that, *Barton* aside, because there is a lack of a pre-payment forum in which they may challenge the overpayment of § 6621(c) interest, their due process rights under the Fifth Amendment have been violated. The Tax Court rejected Petitioner's due process argument. Citing *Phillips v. Commissioner,* 283 U.S. 589, 595, 51 S.Ct. 608, 75 L.Ed. 1289 (1931) and *Johnston v. Commissioner,* 429 F.2d 804, 806 (6th Cir.1970), the Tax Court held that the law is well settled that the availability to a taxpayer of a post-payment judicial forum in which to obtain a determination of his tax obligations is sufficient to satisfy due process requirements. (J.A. at 282-84.) We agree with the Tax Court and opine that because Petitioners had available to them judicial forums wherein they could seek redetermination of the alleged overpayments, and where Petitioners have in fact availed themselves of such forums, they have received all the process to which they are entitled. *See Johnston,* 429 F.2d at 806. We conclude that this is particularly so where Petitioners did not dispute that their underpayment was attributable to tax-motivated transactions, nor did they dispute the Commissioner's calculation of the amount owing.

We further conclude that Petitioners' argument that the interest assessment is void because the Commissioner did not issue a notice of deficiency with respect to the disputed interest before assessing it, is likewise without merit. Section 6601(e)(1) mandates that interest prescribed by section 6601, "shall be ... assessed, collected, and paid in the same manner as taxes," and is treated as a tax "except [for purposes of] subchapter B of chapter 63, relating to deficiency procedures." 26 U.S.C. § 6601(e)(1). Accordingly, this provision authorizes the Commissioner to assess and collect the interest prescribed by § 6601(a) on an underpayment without first issuing a notice of deficiency asserting the taxpayer's liability for the interest. Because the issue in the matter at hand was prescribed by § 6601(a)-albeit at the rate set forth in § 6621(c)-the Commissioner was not required to issue a notice of deficiency with respect to the interest due on Petitioners' 1982 underpayment, and the assessment at issue was valid.

In summary, we conclude that because Petitioners are challenging the overpayment of § 6621(c) interest, the Tax Court had jurisdiction to hear the matter, *see Barton,* 97 T.C. at 554-55, and because Petitioners had a judicial forum available to them wherein they could challenge the overpayment (and in fact availed themselves of that forum), the Tax Court properly exercised jurisdiction over this case and Petitioners were not denied due process of law under the Fifth Amendment. *See Johnston,* 429 F.2d at 806.

II. Whether the Tax Court Properly Determined Negligence on the Part of Petitioners.[2]

We review a Tax Court's factual findings regarding a determination of negligence for purposes of IRC § 6653 under a clearly erroneous standard. *See Pasternak v. Commissioner,* 990 F.2d 893, 902 (6th Cir.1993).

During the years at issue, 1982-1985, section 6653(a)(1) provided for an addition to tax equal to 5% of any underpayment of tax if any part of the underpayment was due to negligence, and section 6653(a)(2) provided for a further addition to tax equal to 50% of the interest payable on the portion of the underpayment attributable to such negligence. *See Pasternak,* 990 F.2d at 902. For purposes of section 6653, "negligence" is defined as " 'lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the circumstances.' " *Id.* (quoting *Leuhsler v. Commissioner,* 963 F.2d 907, 910 (6th Cir.1992)). The Commissioner's determination of negligence is presumed to be correct, and a taxpayer has the burden of showing that he was not negligent. *Id.* (citing *Skeen v. Commissioner,* 864 F.2d 93, 96 (9th Cir.1989)); *see also Illes v. Commissioner,* 982 F.2d 163, 166 (6th Cir.1992).

The Commissioner argues that Petitioners failed to meet their burden of proof in the matter at hand. The Commissioner notes that courts have found that a taxpayer is negligent if he puts his faith in a scheme that, on its face, offers improbably high tax advantages, without obtaining

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[2] Section 6653 was repealed by the Omnibus Budget Reconciliation Act of 1989, effective for returns due after 1989. Negligence of the type at issue here is now one component of the accuracy-related penalty found in Section 6662. *See* 26 U.S.C § 6662(b)(1).

an objective, independent opinion on its validity. According to the Commissioner, the Dickinson offering here was such a scheme, and Petitioners failed to obtain the independent assurance of validity before investing, thereby making them negligent. We agree.

The offering memorandum revealed that Dickinson would acquire rights to four Sentinel recycling machines through an elaborate series of simultaneous paper transactions, and quoted an exorbitant price of $1,500,000 for each machine, for which there was no established market, while warning that the IRS might challenge that price as being in excess of fair market value. Based upon the recited price, the offering memorandum also projected that in the initial year, each partner would receive tax savings almost double his investment in the partnership. In addition to these "too good to be true" returns on an investment, the offering memorandum also expressly warned potential investors as to the high degree of tax risk. For example, the offering provided in bold capital letters, **"THIS OFFERING INVOLVES A HIGH DEGREE OF RISK"**; stated that "[a]n investment in the partnership involves a high degree of business and tax risks and should, therefore, be considered only by persons who ... can afford to lose all of their cash investment and all or a portion of their anticipated tax benefits"; and also stated that there was a substantial likelihood of audit by the IRS. (J.A. at 125, 135.) The offering memorandum further warned that the partnerships had no prior operating history, that the general partner had no prior experience in marketing recycling equipment, that there was no established market for the Sentinel recyclers, and that there was no assurance that market prices for virgin resin would remain at their then-current level.

Outside sources also warned Barlow not to invest in the Dickinson offering. Specifically, Philip Nusholtz, an attorney with whom Barlow had a long-standing professional relationship, and whose tax advice Barlow valued and trusted, advised Barlow not to invest in the Dickenson offering. Nusholtz refused to read the offering memorandum and advised Barlow not to invest in any offering made by promoter Fred Gordon. Barlow invested $50,000 in the Dickinson offering despite these warnings and knowledge of the risky nature of the investment. And, four months after making the investment, Barlow claimed the promised tax benefits on his 1982 tax returns, thereby reducing his tax liability for that year by over $96,000.

The Tax Court found that Barlow's primary motivation for investing in the Dickinson offering was to obtain these tax savings, and Barlow does not challenge the Tax Court's finding in this regard. As a result, it is undisputed that Barlow invested in a sham transaction without the primary profit motivation, which in itself is enough to find Petitioners' claim on this issue to be without merit. *See Howard v. Commissioner*, 931 F.2d 578, 582 (9th Cir.1991) ("In a case ... where the taxpayers have been found to have entered into sham transactions without a primary profit motivation, they have failed to meet their burden of showing due care.")

Barlow claims that he relied on the advice that he received from his accountant and tax return preparer, Gerald Kabeck, prior to investing in Dickinson, and that reliance on this professional advice serves as a basis for finding that he was not negligent. Good faith reliance on a tax advisor professional concerning tax laws is a defense to negligence. *See United States v. Boyle*, 469 U.S. 241, 246, 105 S.Ct. 687, 83 L.Ed.2d 622 (1985); *Zfass v. Commissioner*, 118 F.3d 184, 188 (4th Cir.1997). "However, that reliance must

be reasonable and the taxpayer must show that the accountant had all the necessary information to make an informed decision." *See Zfass,* 118 F.3d at 188. Here, Petitioners have failed to show that Barlow acted reasonably or that Kabeck had all the information to make an informed decision. For example, the record indicates that Barlow was an educated man and a sophisticated investor, and yet he did not heed the warnings set forth in the offering memorandum, nor did he accept the advice of his long-time friend and advisor, attorney Philip Nusholtz. In addition, as the Tax Court found, Kabeck did not have the knowledge and expertise to advise Barlow inasmuch as Kabeck did not have any firsthand knowledge about the leasing transactions involved in this case, nor did he have any experience in the area of plastic recycling or in the area of investment-related advice in general. As a result, Petitioners have failed to meet their burden in demonstrating that Barlow was not negligent when he invested in the Dickinson offering. *See id.*

CONCLUSION

For the above-stated reasons, we **AFFIRM** the Tax Court's orders.

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

2008-5004

KENNETH C. KEENER, WILLIAM P. SMITH,
and ANNE D. SMITH,

Plaintiffs-Appellants,

v.

UNITED STATES,

Defendants-Appellee.

Appeal from the United States Court of Federal Claims in 03-CV-2028 and 04-CV-907, Judge Francis M. Allegra.

ORDER

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

ORDER

A petition for rehearing en banc having been filed by the Appellants, and the matter having first been referred as a petition for rehearing to the panel that heard the appeal, and thereafter the petition for rehearing en banc having been referred to the circuit judges who are in regular active service,

UPON CONSIDERATION THEREOF, it is

ORDERED that the petition for rehearing be, and the same hereby is, DENIED and it is further

ORDERED that the petition for rehearing en banc be, and the same hereby is, DENIED.

The mandate of the court will issue on March 25, 2009.

FOR THE COURT,

/s/ Jan Horbaly, lms

Jan Horbaly
Clerk

Dated: 03/18/2009

cc: Thomas E. Redding
Deborah K. Snyder

KEENER V US, 2008-5004
(CFC-03-CV-2028

Stamped
Filed
U.S. Court of Appeals for
the Federal Circuit
March 18 2009
Jan Horbaly
Clerk

CONSTITUTION OF THE UNITED STATES OF AMERICA

AMENDMENT I

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.

. . . .

AMENDMENT V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

INTERNAL REVENUE CODE (26 U.S.C.)

SEC. 6221. TAX TREATMENT DETERMINED AT PARTNERSHIP LEVEL

Except as otherwise provided in this subchapter, the tax treatment of any partnership item shall be determined at the partnership level.

SEC. 6222. PARTNER'S RETURN MUST BE CONSISTENT WITH PARTNERSHIP RETURN OR SECRETARY NOTIFIED OF INCONSISTENCY

(a) IN GENERAL.—A partner shall, on the partner's return, treat a partnership item in a manner which is consistent with the treatment of such partnership item on the partnership return.

* * * *

(d) ADDITION TO TAX FOR FAILURE TO COMPLY WITH SECTION.—

For addition to tax in the case of a partner's disregard of requirements of this section, see part II of subchapter A of chapter 68.

SEC. 6226. JUDICIAL REVIEW OF FINAL PARTNERSHIP ADMINISTRATIVE ADJUSTMENTS

(a) PETITION BY TAX MATTERS PARTNER.—Within 90 days after the day on which a notice of a final partnership administrative adjustment is mailed to the tax matters partner, the tax matters partner may file a petition for a readjustment of the partnership items for such taxable year with—

(1) the Tax Court,

(2) the district court of the United States for the district in which the partnership's principal place of business is located, or

(3) the Claims Court.

(b) PETITION BY PARTNER OTHER THAN TAX MATTERS PARTNER—

(1) IN GENERAL.—If the tax matters partner does not file a readjustment petition under subsection (a) with respect to any final partnership administrative adjustment, any notice partner (and any 5-percent group) may, within 60 days after the close of the 90-day period set forth in subsection (a), file a petition for a readjustment of the partnership items for the taxable year involved with any of the courts described in subsection (a).

* * * *

(c) PARTNERS TREATED AS PARTIES.—If an action is brought under subsection (a) or (b) with respect to a partnership for any partnership taxable year—

(1) each person who was a partner in such partnership at any time during such year shall be treated as a party to such action, and

(2) the court having jurisdiction of such action shall allow each such person to participate in the action.

(d) PARTNER MUST HAVE INTEREST IN OUTCOME.—

(1) IN ORDER TO BE PARTY TO ACTION.—Subsection (c) shall not apply to a partner after the day on which—

(A) the partnership items of such partner for the partnership taxable year became nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, or

(B) the period within which any tax attributable to such partnership items may be assessed against that partner expired.

* * * *

(f) SCOPE OF JUDICIAL REVIEW.—A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment relates and the proper allocation of such items among the partners.

* * * *

SEC. 6229. PERIOD OF LIMITATIONS FOR MAKING ASSESSMENTS

(a) GENERAL RULE.—Except as otherwise provided in this section, the period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year shall not expire before the date which is 3 years after the later of—

(1) the date on which the partnership return for such taxable year was filed, or

(2) the last day for filing such return for such year (determined without regard to extensions).

(b) EXTENSION BY AGREEMENT.—

(1) IN GENERAL.—The period described in subsection (a) (including an extension period under this subsection) may be extended—

(A) with respect to any partner, by an agreement entered into by the Secretary and such partner, and

(B) with respect to all partners, by an agreement entered into by the Secretary and the tax matters partner (or any other person authorized by the partnership in writing to enter into such an agreement),

before the expiration of such period.

(2) COORDINATION WITH SECTION 6501(c)(4).—Any agreement under section 6501(c)(4) shall apply with respect to the period described in subsection (a) only if the agreement expressly provides that such agreement applies to tax attributable to partnership items.

(c) SPECIAL RULE IN CASE OF FRAUD, ETC.—

* * * *

(3) NO RETURN .—In the case of a failure by a partnership to file a return for any taxable year, any tax attributable to a partnership item (or affected item) arising in such year may be assessed at any time.

* * * *

(d) SUSPENSION WHEN SECRETARY MAKES ADMINISTRATIVE ADJUSTMENT .—If notice of a final partnership administrative adjustment with respect to any taxable year is mailed to the tax matters partner, the running of the period specified in subsection (a) (as modified by other provisions of this section) shall be suspended—

(1) for the period during which an action may be brought under section 6226 (and, if an action an action with respect to such administrative adjustment is brought during such period, until the decision of the court in such action becomes final), and

(2) for 1 year thereafter.

* * * *

(f) ITEMS BECOMING NONPARTNERSHIP ITEMS.—If, before the expiration of the period otherwise provided in this section for assessing any tax imposed by subtitle A with respect to the partnership items of a partner for the partnership taxable year, such items become nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, the period for assessing any tax imposed by subtitle A which is attributable to such items (or any item affected by such items) shall not expire before the date which is 1 year after the date on which the items become nonpartnership items. The period described in the preceding sentence (including

any extension period under this sentence) may be extended with respect to any partner by agreement entered into by the Secretary and such partner.

* * * *

SEC. 6230. ADDITIONAL ADMINISTRATIVE PROVISIONS

(a) COORDINATION WITH DEFICIENCY PROCEEDINGS.—

(1) IN GENERAL.—Except as provided in paragraph (2), subchapter B of this chapter shall not apply to the assessment or collection of any computational adjustment.

(2) DEFICIENCY PROCEEDINGS TO APPLY IN CERTAIN CASES.—

(A) Subchapter B shall apply to any deficiency attributable to—

(i) affected items which require partner level determinations, or

(ii) items which have become nonpartnership items (other than by reason of section 6231(b)(1)(C)) and are described in section 6231(e)(1)(B).

* * * *

(d) SPECIAL RULES WITH RESPECT TO CREDITS OR REFUNDS ATTRIBUTABLE TO PARTNERSHIP ITEMS.—

(1) IN GENERAL.—Except as otherwise provided in this subsection, no credit or refund of an overpayment attributable to a partnership item (or an affected item) for a partnership taxable year shall be allowed or made to any partner after the expiration of the period of limitation prescribed in section 6229 with respect to

such partner for assessment of any tax attributable to such item.

(2) ADMINISTRATIVE ADJUSTMENT REQUEST.—If a request for an administrative adjustment under section 6227 with respect to a partnership item is timely filed, credit or refund of any overpayment attributable to such partnership item (or an affected item) may be allowed or made at any time before the expiration of the period prescribed in section 6228 for bringing suit with respect to such request.

(3) CLAIM UNDER SUBSECTION (c).—If a timely claim is filed under subsection (c) for a credit or refund of an overpayment attributable to a partnership item (or affected item), credit or refund of such overpayment may be allowed or made at any time before the expiration of the period specified in section 6532 (relating to periods of limitations on suits) for bringing suit with respect to such claim.

(4) TIMELY SUIT.—Paragraph (1) shall not apply to any credit or refund of any overpayment attributable to a partnership item (or an item affected by such partnership item) if a partner brings a timely suit with respect to a timely administrative adjustment request under section 6228 or a timely claim under subsection (c) relating to such overpayment.

(5) OVERPAYMENTS REFUNDED WITHOUT REQUIREMENT THAT PARTNER FILE CLAIM .—In the case of any overpayment by a partner which is attributable to a partnership item (or an affected item) and which may be refunded under this subchapter, to the extent practicable credit or refund of such overpayment shall be allowed or made without any requirement that the partner file a claim therefor.

* * * *

SEC. 6231. DEFINITIONS AND SPECIAL RULES

(a) DEFINITIONS.—For purposes of this subchapter—

* * * *

(3) PARTNERSHIP ITEM .—The term "partnership item" means, with respect to a partnership, any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

(4) NONPARTNERSHIP ITEM .—The term "nonpartnership item" means an item which is (or is treated as) not a partnership item.

(5) AFFECTED ITEM .—The term "affected item" means any item to the extent such item is affected by a partnership item.

* * * *

(b) ITEMS CEASE TO BE PARTNERSHIP ITEMS IN CERTAIN CASES.—

(1) IN GENERAL.—For purposes of this subchapter, the partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date—

* * * *

(C) the Secretary enters into a settlement agreement with the partner with respect to such items, or

* * * *

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION

(a) GENERAL RULE.—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

* * * *

(c) EXCEPTIONS.—

* * * *

(3) NO RETURN.—In the case of failure to file a return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * *

SEC. 6621. DETERMINATION OF RATE OF INTEREST

* * * *

(c) INTEREST ON SUBSTANTIAL UNDERPAYMENTS ATTRIBUTABLE TO TAX MOTIVATED TRANSACTIONS.—

(1) IN GENERAL.—In the case of interest payable under section 6601 with respect to any substantial underpayment attributable to tax motivated transactions, the rate of interest established under this section shall be 120 percent of the underpayment rate established under this subsection.

(2) SUBSTANTIAL UNDERPAYMENT ATTRIBUTABLE TO TAX MOTIVATED TRANSACTIONS.—For purposes of this subsection, the term "substantial underpayment attributable to tax motivated transactions" means any underpayment of taxes imposed by subtitle A for any taxable year which is attributable to 1 or more tax motivated transactions if the amount of the underpayment for such year so attributable exceeds $1,000.

(3) TAX MOTIVATED TRANSACTIONS—

(A) In general.—For purposes of this subsection, the term "tax motivated transaction" means—

(i) any valuation overstatement (within the meaning of section 6659(c)),

(ii) any loss disallowed by reason of section 465(a) and any credit disallowed under section 46(a)(8),

(iii) any straddle (as defined in section 1092(c) without regard to subsections (d) and (e) of section 1092),

(iv) any use of an accounting method specified in regulations prescribed by the Secretary as a use which may result in a substantial distortion of income for any period, and

(v) any sham or fraudulent transaction.

* * * *

SEC. 7422. CIVIL ACTIONS FOR REFUND

(a) No suit prior to filing claim for refund.--No suit or proceeding shall be maintained in any court for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.

* * * *

(h) Special rule for actions with respect to partnership items.—No action may be brought for a refund attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c).

SEC. 7441. STATUS

There is hereby established, under article I of the Constitution of the United States, a court of record to be known as the United States Tax Court. The members of the Tax Court shall be the chief judge and the judges of the Tax Court.

SEC. 7442. JURISDICTION

The Tax Court and its divisions shall have such jurisdiction as is conferred on them by this title, by chapters 1, 2, 3, and 4 of the Internal Revenue Code of 1939, by title II and title III of the Revenue Act of 1926 (44 Stat. 10-87), or by laws enacted subsequent to February 26, 1926.

JUDICIARY AND JUDICIAL PROCEDURE (28 U.S.C.)

§1346. UNITED STATES AS DEFENDANT

(a) The district courts shall have original jurisdiction, concurrent with the United States Court of Federal Claims, of:

(1) Any civil action against the United States for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal-revenue laws.

§1491. CLAIMS AGAINST UNITED STATES GENERALLY; ACTIONS INVOLVING TENNESSEE VALLEY AUTHORITY

(a)(1) The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort. For the purpose of this paragraph, an express or implied contract with the Army and Air Force Exchange Service, Navy Exchanges, Marine Corps Exchanges, Coast Guard Exchanges, or Exchange Councils of the National Aeronautics and Space Administration shall be considered an express or implied contract with the United States.

(2) To provide an entire remedy and to complete the relief afforded by the judgment, the court may, as an incident of and collateral to any such judgment, issue

orders directing restoration to office or position, placement in appropriate duty or retirement status, and correction of applicable records, and such orders may be issued to any appropriate official of the United States. In any case within its jurisdiction, the court shall have the power to remand appropriate matters to any administrative or executive body or official with such direction as it may deem proper and just. The Court of Federal Claims shall have jurisdiction to render judgment upon any claim by or against, or dispute with, a contractor arising under section 10(a)(1) of the Contract Disputes Act of 1978, including a dispute concerning termination of a contract, rights in tangible or intangible property, compliance with cost accounting standards, and other nonmonetary disputes on which a decision of the contracting officer has been issued under section 6 of that Act.

[(3) Repealed. Pub.L. 104-320, §12(a)(2), Oct. 19, 1996, 110 Stat. 3874]

Federal Regulations
Effective for the Tax Years in Issue

Treas. Reg. §301.6621-2T. Questions and answers relating to the increased rate of interest on substantial underpayments attributable to certain tax motivated transactions (temporary).

The following questions and answers relate to the increased rate of interest on substantial underpayments attributable to certain tax motivated transactions as provided in section 6621(d) of the Internal Revenue Code of 1954, as added by section 144 of the Tax Reform Act of 1984 (Pub.L. 98-369, 98 Stat. 682):

* * * *

Q-5. How is the amount of a tax motivated underpayment determined?

A-5. Except as provided in A-6 of this section, the amount of a tax motivated underpayment is determined in the following manner:

(1) Calculate the amount of the tax liability for the taxable year as if all items of income, gain, loss, deduction, or credit, had been reported properly on the income tax return of the taxpayer ("total tax liability"); and

(2) Without taking into account any adjustments to items of income, gain, loss, deduction, or credit that are attributable to tax motivated transactions (as defined in A-2 through A-4 of this section), calculate the amount of the tax liability for the taxable year as if all other items of income, gain, loss, deduction, or credit had been reported properly on the income tax return of the taxpayer ("tax liability without regard to tax motivated transactions").

(3) The difference between the total tax liability and the tax liability without regard to tax motivated transactions is the amount of the tax motivated underpayment.

Example. Taxpayer A, a calendar year taxpayer, files his 1984 income tax return reporting $70,000 of taxable income and $23,171 of tax liability. On January 20, 1986, A enters into a closing agreement with the Internal Revenue Service that includes the following adjustments:

Section 162 deduction disallowed (not tax motivated)	$ 7,500
Loss disallowed under section 465 (tax motivated--see A-2(2) of this section)	$ 5,000
Section 170 deduction disallowed because of a valuation overstatement (tax motivated--see A-2(1) of this section	$10,000
Loss disallowed with respect to a straddle as defined in section 1092 (c) (tax motivated--see A-2(4) of this section	$ 7,000
Other adjustments (none of which are tax motivated)	$ 4,000

The tax motivated underpayment is determined in the following manner:

1.	$ 70,000	reported taxable income
	+ 33,500	(Add all adjustments to items of income, gain, loss, deduction, or credit (including tax motivated transactions subject to section 6621(d)))
	$103,500	Tax = $39,685 ("total tax liability")

2.	$ 70,000	reported taxable income
	+ 11,500	(Add adjustments to items of income, gain, loss, deduction, or credit other than those with respect to items that are tax motivated)
	$ 81,500	tax = $28,691 ("tax liability without regard to tax motivated transactions")

The tax motivated underpayment (*i.e.*, the underpayment attributable to tax motivated transactions) is $10,994 ($39,685–$28,691). Accordingly, the interest on $10,994 would be computed at the 120 percent rate.

The remainder of the underpayment (*i.e.*, the underpayment not attributable to tax motivated transactions) is $5,520 ($28,691 (tax liability without regard to tax motivated items)–$23,171 (tax paid with return)). The interest on $5,520 would be computed at the adjusted rate.

Treas. Reg. §301.6231(a)(3)-1 Partnership items.

(b) *Factors that affect the determination of partnership items.* The term "partnership item" includes the accounting practices and the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc. Examples of these determinations are: The partnership's method of accounting, taxable year, and inventory method; whether an election was made by the partnership; whether partnership property is a capital asset, section 1231 property, or inventory; whether an item is currently deductible or must be capitalized; whether partnership activities have been engaged in with the intent to make a profit for purposes of section 183; and whether the partnership qualifies for the research and development credit under section 30.

AMCOR Partner-Level Refund Suits for Settled Partners in the District Courts of the Fifth Circuit With Agreed Final Judgments Entered Requiring Refund of §6621(c) Penalty Interest, Where the Tax Liability of at Least One Partner Arose from His or Her Interest in **Agri Venture II**

Suit	Court	Docket No.	Agreed Final Judgment Entered
Boldrick v. United States	WDTX	03-00016	8/29/08
Burkeholder v. United States	NDTX	03-00041	10/10/08
Coe v. United States	SDTX	03-03495	9/19/08
Hampton v. United States	SDTX	03-03885	9/18/08
Matthews v. United States	SDTX	00-04131	10/7/08
McKinney v. United States	SDTX	00-03777	9/18/08

AMCOR Partner-Level Refund Suits for Settled Partners in the District Courts of the Fifth Circuit With Agreed Final Judgments Entered Requiring Refund of §6621(c) Penalty Interest, Where the Tax Liability of at Least One Partner Arose from His or Her Interest in **Agri Venture Fund**

Suit	Court	Docket No.	Agreed Final Judgment Entered
Braxton v. United States	EDTX	06-00328	10/22/08
Burkeholder v. United States	NDTX	03-00041	10/10/08
Crawford v. United States	SDTX	06-02054	8/21/08
Eckert v. United States	SDTX	02-03890	8/27/08
Hagerty v. United States	SDTX	05-01701	9/18/08
Hampton v. United States	SDTX	03-03885	9/18/08
Hill v. United States	SDTX	04-02905	9/11/08
Kapusta v. United States	SDTX	03-03929	8/6/08
Kyle v. United States	SDTX	03-03923	8/27/08
Marett v. United States	WDTX	03-00936	9/2/08
Street v. United States	SDTX	01-01598	9/18/08

AMCOR Partner-Level Refund Suits for Settled Partners in the District Courts of the Fifth Circuit With Agreed Final Judgments Entered Requiring Refund of §6621(c) Penalty Interest, Where the Tax Liability of at Least One Partner Arose from His or Her Interest in **Desert Highland Vineyards**

Suit	Court	Docket No.	Agreed Final Judgment Entered
Rutherford v. United States	SDTX	02-04161	10/6/08
Street v. United States	SDTX	01-01598	9/18/08

AMCOR Partner-Level Refund Suits for Settled Partners in the District Courts of the Fifth Circuit With Agreed Final Judgments Entered Requiring Refund of §6621(c) Penalty Interest, Where the Tax Liability of at Least One Partner Arose from His or Her Interest in **Richgrove Grape Associates**

Suit	Court	Docket No.	Agreed Final Judgment Entered
Boldrick v. United States	WDTX	03-00016	8/29/08
Boyd v. United States	SDTX	03-00406	9/18/08

KENNETH C. KEENER
(SSN XXX-XX-XXXX)
EXPLANATION - 1984 REFUND CLAIM

This refund claim, as it relates to tax and interest assessed relative to adjustments to partnership items and affected items related to the Agri-Venture II partnership (referred to in this explanation as "the Partnership") for 1984 (referred to in this explanation as "the settlement years"), is filed based upon the following grounds:

1. The assessment of tax and interest was made after the statute of limitations had already expired. Any amount assessed and collected after the statute of limitations has expired constitutes an overpayment pursuant to Internal Revenue Code §6401. The assessment related to the Partnership was made more than three years after the Partnership return was filed. The settlement upon which the assessment was based was solicited by the Internal Revenue Service and entered into utilizing a Form 870-P(AD) after the statute of limitations had expired. *Alexander v. United States*, 44 F.3d 328 (5th Cir. 1995), and *Ewing v. United States*, 914 F.2d 499 (4th Cir. 1990). The Form 870-P(AD), did not waive the statute of limitations. An extension of the statute of limitations must be pursuant to a written agreement entered into "before the expiration of such period." I.R.C. §6229(b)(1). See Rev. Rul. 74-580, 1974-2 C.B. 400, *Alexander, supra; Melahn v. Commissioner*, 9 T.C. 768 (1947). (Neither an invalid Notice of Final Partnership Administrative Adjustment ("FPAA") nor an invalid petition filed with the Tax Court suspends the limitations period, nor does a settlement agreement entered into after the statute of limitations has expired reopen the period for assessment.) A Form 870-P(AD) provides that "no claim for refund or credit based on any change in the treatment of partnership items may be filed or prosecuted." [Emphasis added.] This claim does not seek a change in the treatment of the partnership items. This

claim concedes that the partnership items should, in fact, be adjusted as agreed on the Form 870-P(AD) and it is, therefore, not necessary to show fraud, malfeasance or misrepresentation. The claim is not barred by the Form 870-P(AD) because the claim does not seek a change in the "treatment of partnership items."

2. Any amount assessed and collected after the statute of limitations had expired constitutes a refundable overpayment pursuant to I.R.C. §6401. *Alexander, supra; Cohen v. Commissioner*, 91-2 U.S.T.C. ¶50,384 (1991) *aff'd.* 995 F.2d 205 (Fed. Cir. 1993).

3. The claim is timely. It is being filed within two years from the date of payment. Additionally, even if any of the periods under I.R.C. §6230 apply to any portion of this claim, it is timely under those provisions as well.

4. In the alternative, even if the statute of limitations does not bar the assessment and collection of tax, taxpayer(s) are not liable for the penalty portion of the interest paid under I.R.C. §6621(c). To the extent the tax deficiencies upon which the I.R.C. §6621(c) interest was assessed arose from agreed adjustments to partnership items, based upon an agreement under I.R.C. §6224(c), the partnership item adjustments were based solely on amounts offered as adjustments by the taxpayers and accepted by the IRS. No trial was conducted. To the extent the deficiency is based on an I.R.C. §6224(c) agreed settlement that was entered into, such agreement provided solely for certain specific adjustments to partnership items. The assessment that resulted from the agreed settlement reflected only a concession to the partnership item adjustments, which avoided the requirement of a trial on each of the elements set out in the relevant original FPAA. There was no agreement that the adjustments resulted from tax motivated transactions as defined in I.R.C. §6621(c) or the relevant regulations.

5. Additionally, or alternatively, it is clear that several of the initial proposed bases for the adjustments set forth in the original FPAA were independent of any basis that would have constituted a "tax motivated transaction." The controlling Tax Court case is *McCrary v. Commissioner,* 92 T.C. 827 (1989). This case clearly established that to the extent the taxpayers made concessions to avoid the necessity for litigation and where the basis of concession did not require the Court to determine if the adjustments were specifically "attributable to" a tax-motivated transaction, the §6621(c) penalty was inapplicable, even though some of the IRS's alternative grounds in the original FPAA for disallowance would support it! *See also Todd v. Commissioner* , 862 F.2d 540 (5th Cir. 1988). Treasury Regulation §301.6621-2T, A-5, Temporary Proced. & Admin. Regs., 49 Fed. Reg. 59394 (Dec. 28, 1984) also supports this position.

6. Alternatively, even if the doctrine under *Todd*, *McCrary*, and Treas. Reg. §301.6221-2T, A-5 does not preclude the application of I.R.C. §6221(c), no portion of the underlying tax liability was attributable to any event defined in I.R.C. §6221(c) or the regulations thereunder as a tax motivated transaction.

7. The recomputation of interest takes into account the doctrine in *Avon Products*, 78-2 U.S.T.C. ¶9821 (1978), pursuant to which it has been determined, and conceded by the government, that interest does not begin to run on a deficiency of tax until the date on which a refund was paid if no interest was paid with the original refund.

8. As an alternative, and in addition to the grounds set forth above, interest should be abated pursuant to I.R.C. §6404 as follows:

(a) First, interest should be abated for the period beginning with the commencement of the IRS' criminal investigation of Mr. Behrens and Mr. Wright and ending

with the termination of the criminal investigation. The suspension of the civil proceedings during that time period constituted an unreasonable delay in the proceedings due to a managerial or ministerial act. The refund claim computations have used a suspension period from March 21, 1989 to April 1, 1993, based on the dates the IRS invaded the general partner's office and served criminal subpoenas to the date the general partners were notified of the abandonment of the criminal investigation. The period of suspension should actually be longer based on when the referral to the criminal investigation division was first made to the date when all partnership records were returned to the general partners, and the IRS should recompute and pay the greater amount under this claim based on those dates. The interest accrued on the tax deficiencies during the erroneous and unreasonable conduct of a criminal investigation of the general partners, seizure, disorganization and loss of partnership records in the course of that investigation, delay or suspension of the civil examination and adjustment process, resulted in impairment of the ability to defend against the IRS' eventually asserted adjustments to partnership items, all of which constituted managerial or ministerial acts which were unreasonable errors and delays by officers or employees of the IRS acting in their official capacities. All such acts occurred after the IRS first contacted the tax matters partners in writing with regard to the civil partnership level return examination.

(b) Second, interest should be abated for the period beginning with a date 45 days after the acceptance by the IRS of the settlement offer and ending on the date of assessment of the income tax liability. The failure to promptly assess the tax deficiency was clearly a managerial or ministerial act resulting in an unreasonable delay of the tax assessment.

9. As an alternative, and in addition to the grounds set forth above, the taxpayer(s) are entitled to the benefit of a net rate of interest of zero pursuant to I.R.C. §6621(d) and a refund of the interest paid on the portion of the deficiency equal to the amount of any refund with respect to which the taxpayer(s) were entitled to receive interest for the periods during which interest was charged on such portion of the deficiency and is payable on such refunds. Substantial refunds are due for 1987 and later years as a result of changes to affected items of the taxpayer(s) resulting from the settlement. This claim constitutes the taxpayer(s)' request that the Secretary apply §6621(d) to all such periods, which includes all periods from April 15, 1988 until the date of payment of the tax sought to be refunded under this claim. Overpayments occurred in each year from 1987 to 1995 due to over reporting of §§441/447 recapture.

Exhibits:

A - Evidence of settlement

B - Evidence of tax assessment and payment

KENNETH C. KEENER
(SSN XXX-XX-XXXX)
EXPLANATION - 1985 REFUND CLAIM

This refund claim, as it relates to tax and interest assessed relative to adjustments to partnership items and affected items related to the Agri-Venture Fund partnership (referred to in this explanation as "the Partnership") for 1985 (referred to in this explanation as "the settlement years"), is filed based upon the following grounds:

1. The assessment of tax and interest was made after the statute of limitations had already expired. Any amount assessed and collected after the statute of limitations has expired constitutes an overpayment pursuant to Internal Revenue Code §6401. The assessment related to the Partnership was made more than three years after the Partnership return was filed. The settlement upon which the assessment was based was solicited by the Internal Revenue Service and entered into utilizing a Form 870-P(AD) after the statute of limitations had expired. *Alexander v. United States*, 44 F.3d 328 (5th Cir. 1995), and *Ewing v. United States*, 914 F.2d 499 (4th Cir. 1990). The Form 870-P(AD), did not waive the statute of limitations. An extension of the statute of limitations must be pursuant to a written agreement entered into "before the expiration of such period." I.R.C. §6229(b)(1). See Rev. Rul. 74-580, 1974-2 C.B. 400, *Alexander, supra; Melahn v. Commissioner*, 9 T.C. 768 (1947). (Neither an invalid Notice of Final Partnership Administrative Adjustment ("FPAA") nor an invalid petition filed with the Tax Court suspends the limitations period, nor does a settlement agreement entered into after the statute of limitations has expired reopen the period for assessment.) A Form 870-P(AD) provides that "no claim for refund or credit based on any change in the treatment of partnership items may be filed or prosecuted." [Emphasis added.] This claim does not seek a change in the treatment of the partnership items. This

claim concedes that the partnership items should, in fact, be adjusted as agreed on the Form 870-P(AD) and it is, therefore, not necessary to show fraud, malfeasance or misrepresentation. The claim is not barred by the Form 870-P(AD) because the claim does not seek a change in the "treatment of partnership items."

2. Any amount assessed and collected after the statute of limitations had expired constitutes a refundable overpayment pursuant to I.R.C. §6401. *Alexander, supra; Cohen v. Commissioner*, 91-2 U.S.T.C. ¶50,384 (1991) *aff'd.* 995 F.2d 205 (Fed. Cir. 1993).

3. The claim is timely. It is being filed within two years from the date of payment. Additionally, even if any of the periods under I.R.C. §6230 apply to any portion of this claim, it is timely under those provisions as well.

4. In the alternative, even if the statute of limitations does not bar the assessment and collection of tax, taxpayer(s) are not liable for the penalty portion of the interest paid under I.R.C. §6621(c). To the extent the tax deficiencies upon which the I.R.C. §6621(c) interest was assessed arose from agreed adjustments to partnership items, based upon an agreement under I.R.C. §6224(c), the partnership item adjustments were based solely on amounts offered as adjustments by the taxpayers and accepted by the IRS. No trial was conducted. To the extent the deficiency is based on an I.R.C. §6224(c) agreed settlement that was entered into, such agreement provided solely for certain specific adjustments to partnership items. The assessment that resulted from the agreed settlement reflected only a concession to the partnership item adjustments, which avoided the requirement of a trial on each of the elements set out in the relevant original FPAA. There was no agreement that the adjustments resulted from tax motivated transactions as defined in I.R.C. §6621(c) or the relevant regulations.

5. Additionally, or alternatively, it is clear that several of the initial proposed bases for the adjustments set forth in the original FPAA were independent of any basis that would have constituted a "tax motivated transaction." The controlling Tax Court case is *McCrary v. Commissioner,* 92 T.C. 827 (1989). This case clearly established that to the extent the taxpayers made concessions to avoid the necessity for litigation and where the basis of concession did not require the Court to determine if the adjustments were specifically "attributable to" a tax-motivated transaction, the §6621(c) penalty was inapplicable, even though some of the IRS's alternative grounds in the original FPAA for disallowance would support it! *See also Todd v. Commissioner* , 862 F.2d 540 (5th Cir. 1988). Treasury Regulation §301.6621-2T, A-5, Temporary Proced. & Admin. Regs., 49 Fed. Reg. 59394 (Dec. 28, 1984) also supports this position.

6. Alternatively, even if the doctrine under *Todd*, *McCrary*, and Treas. Reg. §301.6221-2T, A-5 does not preclude the application of I.R.C. §6221(c), no portion of the underlying tax liability was attributable to any event defined in I.R.C. §6221(c) or the regulations thereunder as a tax motivated transaction.

7. The recomputation of interest takes into account the doctrine in *Avon Products*, 78-2 U.S.T.C. ¶9821 (1978), pursuant to which it has been determined, and conceded by the government, that interest does not begin to run on a deficiency of tax until the date on which a refund was paid if no interest was paid with the original refund.

8. As an alternative, and in addition to the grounds set forth above, interest should be abated pursuant to I.R.C. §6404 as follows:

(a) First, interest should be abated for the period beginning with the commencement of the IRS' criminal investigation of Mr. Behrens and Mr. Wright and ending

with the termination of the criminal investigation. The suspension of the civil proceedings during that time period constituted an unreasonable delay in the proceedings due to a managerial or ministerial act. The refund claim computations have used a suspension period from March 21, 1989 to April 1, 1993, based on the dates the IRS invaded the general partner's office and served criminal subpoenas to the date the general partners were notified of the abandonment of the criminal investigation. The period of suspension should actually be longer based on when the referral to the criminal investigation division was first made to the date when all partnership records were returned to the general partners, and the IRS should recompute and pay the greater amount under this claim based on those dates. The interest accrued on the tax deficiencies during the erroneous and unreasonable conduct of a criminal investigation of the general partners, seizure, disorganization and loss of partnership records in the course of that investigation, delay or suspension of the civil examination and adjustment process, resulted in impairment of the ability to defend against the IRS' eventually asserted adjustments to partnership items, all of which constituted managerial or ministerial acts which were unreasonable errors and delays by officers or employees of the IRS acting in their official capacities. All such acts occurred after the IRS first contacted the tax matters partners in writing with regard to the civil partnership level return examination.

(b) Second, interest should be abated for the period beginning with a date 45 days after the acceptance by the IRS of the settlement offer and ending on the date of assessment of the income tax liability. The failure to promptly assess the tax deficiency was clearly a managerial or ministerial act resulting in an unreasonable delay of the tax assessment.

9. As an alternative, and in addition to the grounds set forth above, the taxpayer(s) are entitled to the benefit of a net rate of interest of zero pursuant to I.R.C. §6621(d) and a refund of the interest paid on the portion of the deficiency equal to the amount of any refund with respect to which the taxpayer(s) were entitled to receive interest for the periods during which interest was charged on such portion of the deficiency and is payable on such refunds. Substantial refunds are due for 1987 and later years as a result of changes to affected items of the taxpayer(s) resulting from the settlement. This claim constitutes the taxpayer(s)' request that the Secretary apply §6621(d) to all such periods, which includes all periods from April 15, 1988 until the date of payment of the tax sought to be refunded under this claim. Overpayments occurred in each year from 1987 to 1995 due to over reporting of §§441/447 recapture.

Exhibits:

A - Evidence of settlement

B - Evidence of tax assessment and payment

WILLIAM P. SMITH and ANN D. SMITH
(SSN XXX-XX-XXXX and SSN XXX-XX-XXXX)
EXPLANATION - 1984 and 1981 REFUND CLAIM
AND STATEMENT REQUESTING
APPLICATION OF §6621(d)

This refund claim, as it relates to tax and interest assessed relative to adjustments to partnership items and affected items related to the Richgrove Grape Associates partnership (referred to in this explanation as "the Partnership") for 1984 and I.T.C. carryback to 1981 (referred to in this explanation as "the settlement years"), is filed based upon the following grounds:

1. The assessment of tax and interest was made after the statute of limitations had already expired. Any amount assessed and collected after the statute of limitations has expired constitutes an overpayment pursuant to Internal Revenue Code §6401. The assessment related to the Partnership was made more than three years after the Partnership return was filed. The settlement upon which the assessment was based was solicited by the Internal Revenue Service and entered into utilizing a Form 870-P(AD) after the statute of limitations had expired. *Alexander v. United States*, 44 F.3d 328 (5th Cir. 1995), and *Ewing v. United States*, 914 F.2d 499 (4th Cir. 1990). The Form 870-P(AD), did not waive the statute of limitations. An extension of the statute of limitations must be pursuant to a written agreement entered into "before the expiration of such period." I.R.C. §6229(b)(1). See Rev. Rul. 74-580, 1974-2 C.B. 400, *Alexander, supra; Melahn v. Commissioner*, 9 T.C. 768 (1947). (Neither an invalid Notice of Final Partnership Administrative Adjustment ("FPAA") nor an invalid petition filed with the Tax Court suspends the limitations period, nor does a settlement agreement entered into after the statute of limitations has expired reopen the period for assessment.) A Form 870-P(AD) provides that "no claim for refund or credit based on any

change in the treatment of partnership items may be filed or prosecuted." [Emphasis added.] This claim does not seek a change in the treatment of the partnership items. This claim concedes that the partnership items should, in fact, be adjusted as agreed on the Form 870-P(AD) and it is, therefore, not necessary to show fraud, malfeasance or misrepresentation. The claim is not barred by the Form 870-P(AD) because the claim does not seek a change in the "treatment of partnership items."

2. Any amount assessed and collected after the statute of limitations had expired constitutes a refundable overpayment pursuant to I.R.C. §6401. *Alexander, supra; Cohen v. Commissioner*, 91-2 U.S.T.C. ¶50,384 (1991) *aff'd.* 995 F.2d 205 (Fed. Cir. 1993).

3. The claim is timely. It is being filed within two years from the date of payment. Additionally, even if any of the periods under I.R.C. §6230 apply to any portion of this claim, it is timely under those provisions as well.

4. In the alternative, even if the statute of limitations does not bar the assessment and collection of tax, taxpayer(s) are not liable for the penalty portion of the interest paid under I.R.C. §6621(c). To the extent the tax deficiencies upon which the I.R.C. §6621(c) interest was assessed arose from agreed adjustments to partnership items, based upon an agreement under I.R.C. §6224(c), the partnership item adjustments were based solely on amounts offered as adjustments by the taxpayers and accepted by the IRS. No trial was conducted. To the extent the deficiency is based on an I.R.C. §6224(c) agreed settlement that was entered into, such agreement provided solely for certain specific adjustments to partnership items. The assessment that resulted from the agreed settlement reflected only a concession to the partnership item adjustments, which avoided the requirement of a trial on each of the elements set out in the relevant original FPAA. There was no agreement that the adjustments resulted

from tax motivated transactions as defined in I.R.C. §6621(c) or the relevant regulations.

5. Additionally, or alternatively, it is clear that several of the initial proposed bases for the adjustments set forth in the original FPAA were independent of any basis that would have constituted a "tax motivated transaction." The controlling Tax Court case is *McCrary v. Commissioner,* 92 T.C. 827 (1989). This case clearly established that to the extent the taxpayers made concessions to avoid the necessity for litigation and where the basis of concession did not require the Court to determine if the adjustments were specifically "attributable to" a tax-motivated transaction, the §6621(c) penalty was inapplicable, even though some of the IRS's alternative grounds in the original FPAA for disallowance would support it! *See also Todd v. Commissioner*, 862 F.2d 540 (5th Cir. 1988). Treasury Regulation §301.6621-2T, A-5, Temporary Proced. & Admin. Regs., 49 Fed. Reg. 59394 (Dec. 28, 1984) also supports this position.

6. Alternatively, even if the doctrine under *Todd*, *McCrary*, and Treas. Reg. §301.6221-2T, A-5 does not preclude the application of I.R.C. §6221(c), no portion of the underlying tax liability was attributable to any event defined in I.R.C. §6221(c) or the regulations thereunder as a tax motivated transaction.

7. The recomputation of interest should take into account the doctrine in *Avon Products*, 78-2 U.S.T.C. ¶9821 (1978), pursuant to which it has been determined, and conceded by the government, that interest does not begin to run on a deficiency of tax until the date on which a refund was paid if no interest was paid with the original refund.

8. As an alternative, and in addition to the grounds set forth above, interest should be abated pursuant to I.R.C. §6404 as follows:

(a) First, interest should be abated for the period beginning with the commencement of the IRS' wrongful seizure of the partnership's books and records during the criminal investigation of Mr. Behrens and Mr. Wright individually, and ending with the termination of the criminal investigation and return of the records to the partnership. The resulting delay of the civil proceedings during that time period constituted an unreasonable delay in the proceedings due to a managerial or ministerial act. The refund claim computations have used a suspension period from March 21, 1989 to April 1, 1993, based on the dates the IRS invaded the general partner's office, served criminal subpoenas on the general partners individually and seized the partnership's records to the date the general partners were notified of the abandonment of the criminal investigation and the records were returned. The period of suspension should actually be longer based on when the referral to the criminal investigation division was first made to the date when all partnership records were returned to the general partners, and the IRS should recompute and pay the greater amount under this claim based on those dates. The interest accrued on the tax deficiencies during the erroneous and unreasonable conduct of a criminal investigation of the general partners, seizure, disorganization and loss of partnership records in the course of that investigation, delay or suspension of the civil examination and adjustment process, resulted in impairment of the ability to defend against adjustments to partnership items the IRS eventually asserted , all of which constituted managerial or ministerial acts which were unreasonable errors and delays by officers or employees of the IRS acting in their official capacities. All such acts occurred after the IRS first contacted the tax matters partners in writing with regard to the civil partnership level return examination.

(b) Second, interest should be abated for the period beginning with a date 45 days after the acceptance by the IRS of the settlement offer and ending on the date of assessment of the income tax liability. The failure to promptly assess the tax deficiency was clearly a managerial or ministerial act resulting in an unreasonable delay of the tax assessment.

9. The settlement agreement entered into was a "Consistent Agreement" under I.R.C. §6224(c), which by statute and the Tax Court's published decisions in the *Greenberg* cases, clearly only applies to a settlement regarding "partnership items" and the applicability of §6621(c) is not a partnership item, nor is the applicability of the abatement provisions pursuant to I.R.C. §6404, nor is any defense based on the statute of limitations, therefore, this claim ***cannot*** be precluded by the terms of the settlement and any attempt to do so by the IRS can only be construed to be frivolous and abusive. Exhibit "____" includes a copy of an excerpt from the settlement agreement clearly stamped as a "Consistent Agreement."

10. As an alternative, and in addition to the grounds set forth above, the taxpayer(s) are entitled to the benefit of a net rate of interest of zero pursuant to I.R.C. §6621(d) and a refund of the interest paid on the portion of the deficiency equal to the amount of any refund with respect to which the taxpayer(s) were entitled to receive interest for the periods during which interest was charged on such portion of the deficiency and is payable on such refunds. This claim constitutes the taxpayer(s)' request that the Secretary apply §6621(d) to all such periods, which includes all periods from April 15, 1994 until the date of payment of the tax sought to be refunded under this claim. To the extent of equivalent amounts of underpayments or overpayments, the periods set forth under §5.063 of Rev. Proc. 99-43 have not previously been applied to obtain a net interest rate of zero under §6621(d). At a minimum, the interest netting I.R.C.

§6621(d) claim should apply to the interest paid on the portion of the deficiency equal to the refund to which the taxpayer(s) are entitled for 1993 resulting from the loss realized upon termination of the taxpayer(s)' Partnership interest in Richgrove Grape Associates and Desert Highland Vineyards due to the increase in the tax basis in the taxpayer(s)' Partnership interest resulting from the settlements regarding both partnerships.

Exhibits:

A - Evidence of settlement

B - Evidence of tax assessment and payment

WILLIAM P. SMITH and ANN D. SMITH
(SSN XXX-XX-XXXX and SSN XXX-XX-XXXX)
EXPLANATION - 1985 REFUND CLAIM
AND STATEMENT REQUESTING
APPLICATION OF §6621(d)

This refund claim, as it relates to tax and interest assessed relative to adjustments to partnership items and affected items related to the Desert Highland Vineyards partnership (referred to in this explanation as "the Partnership") for 1985 (referred to in this explanation as "the settlement years"), is filed based upon the following grounds:

1. The assessment of tax and interest was made after the statute of limitations had already expired. Any amount assessed and collected after the statute of limitations has expired constitutes an overpayment pursuant to Internal Revenue Code §6401. The assessment related to the Partnership was made more than three years after the Partnership return was filed. The settlement upon which the assessment was based was solicited by the Internal Revenue Service and entered into utilizing a Form 870-P(AD) after the statute of limitations had expired. *Alexander v. United States*, 44 F.3d 328 (5th Cir. 1995), and *Ewing v. United States*, 914 F.2d 499 (4th Cir. 1990). The Form 870-P(AD), did not waive the statute of limitations. An extension of the statute of limitations must be pursuant to a written agreement entered into "before the expiration of such period." I.R.C. §6229(b)(1). See Rev. Rul. 74-580, 1974-2 C.B. 400, *Alexander, supra; Melahn v. Commissioner*, 9 T.C. 768 (1947). (Neither an invalid Notice of Final Partnership Administrative Adjustment ("FPAA") nor an invalid petition filed with the Tax Court suspends the limitations period, nor does a settlement agreement entered into after the statute of limitations has expired reopen the period for assessment.) A Form 870-P(AD) provides that "no claim for refund or credit based on any

change in the treatment of partnership items may be filed or prosecuted." [Emphasis added.] This claim does not seek a change in the treatment of the partnership items. This claim concedes that the partnership items should, in fact, be adjusted as agreed on the Form 870-P(AD) and it is, therefore, not necessary to show fraud, malfeasance or misrepresentation. The claim is not barred by the Form 870-P(AD) because the claim does not seek a change in the "treatment of partnership items."

2. Any amount assessed and collected after the statute of limitations had expired constitutes a refundable overpayment pursuant to I.R.C. §6401. *Alexander, supra; Cohen v. Commissioner*, 91-2 U.S.T.C. ¶50,384 (1991) *aff'd.* 995 F.2d 205 (Fed. Cir. 1993).

3. The claim is timely. It is being filed within two years from the date of payment. Additionally, even if any of the periods under I.R.C. §6230 apply to any portion of this claim, it is timely under those provisions as well.

4. In the alternative, even if the statute of limitations does not bar the assessment and collection of tax, taxpayer(s) are not liable for the penalty portion of the interest paid under I.R.C. §6621(c). To the extent the tax deficiencies upon which the I.R.C. §6621(c) interest was assessed arose from agreed adjustments to partnership items, based upon an agreement under I.R.C. §6224(c), the partnership item adjustments were based solely on amounts offered as adjustments by the taxpayers and accepted by the IRS. No trial was conducted. To the extent the deficiency is based on an I.R.C. §6224(c) agreed settlement that was entered into, such agreement provided solely for certain specific adjustments to partnership items. The assessment that resulted from the agreed settlement reflected only a concession to the partnership item adjustments, which avoided the requirement of a trial on each of the elements set out in the relevant original FPAA. There was no agreement that the adjustments resulted

from tax motivated transactions as defined in I.R.C. §6621(c) or the relevant regulations.

5. Additionally, or alternatively, it is clear that several of the initial proposed bases for the adjustments set forth in the original FPAA were independent of any basis that would have constituted a "tax motivated transaction." The controlling Tax Court case is *McCrary v. Commissioner*, 92 T.C. 827 (1989). This case clearly established that to the extent the taxpayers made concessions to avoid the necessity for litigation and where the basis of concession did not require the Court to determine if the adjustments were specifically "attributable to" a tax-motivated transaction, the §6621(c) penalty was inapplicable, even though some of the IRS's alternative grounds in the original FPAA for disallowance would support it! *See also Todd v. Commissioner*, 862 F.2d 540 (5th Cir. 1988). Treasury Regulation §301.6621-2T, A-5, Temporary Proced. & Admin. Regs., 49 Fed. Reg. 59394 (Dec. 28, 1984) also supports this position.

6. Alternatively, even if the doctrine under *Todd*, *McCrary*, and Treas. Reg. §301.6221-2T, A-5 does not preclude the application of I.R.C. §6221(c), no portion of the underlying tax liability was attributable to any event defined in I.R.C. §6221(c) or the regulations thereunder as a tax motivated transaction.

7. The recomputation of interest should take into account the doctrine in *Avon Products*, 78-2 U.S.T.C. ¶9821 (1978), pursuant to which it has been determined, and conceded by the government, that interest does not begin to run on a deficiency of tax until the date on which a refund was paid if no interest was paid with the original refund.

8. As an alternative, and in addition to the grounds set forth above, interest should be abated pursuant to I.R.C. §6404 as follows:

(a) First, interest should be abated for the period beginning with the commencement of the IRS' wrongful seizure of the partnership's books and records during the criminal investigation of Mr. Behrens and Mr. Wright individually, and ending with the termination of the criminal investigation and return of the records to the partnership. The resulting delay of the civil proceedings during that time period constituted an unreasonable delay in the proceedings due to a managerial or ministerial act. The refund claim computations have used a suspension period from March 21, 1989 to April 1, 1993, based on the dates the IRS invaded the general partner's office, served criminal subpoenas on the general partners individually and seized the partnership's records to the date the general partners were notified of the abandonment of the criminal investigation and the records were returned. The period of suspension should actually be longer based on when the referral to the criminal investigation division was first made to the date when all partnership records were returned to the general partners, and the IRS should recompute and pay the greater amount under this claim based on those dates. The interest accrued on the tax deficiencies during the erroneous and unreasonable conduct of a criminal investigation of the general partners, seizure, disorganization and loss of partnership records in the course of that investigation, delay or suspension of the civil examination and adjustment process, resulted in impairment of the ability to defend against adjustments to partnership items the IRS eventually asserted , all of which constituted managerial or ministerial acts which were unreasonable errors and delays by officers or employees of the IRS acting in their official capacities. All such acts occurred after the IRS first contacted the tax matters partners in writing with regard to the civil partnership level return examination.

(b) Second, interest should be abated for the period beginning with a date 45 days after the acceptance by the IRS of the settlement offer and ending on the date of assessment of the income tax liability. The failure to promptly assess the tax deficiency was clearly a managerial or ministerial act resulting in an unreasonable delay of the tax assessment.

9. The settlement agreement entered into was a "Consistent Agreement" under I.R.C. §6224(c), which by statute and the Tax Court's published decisions in the *Greenberg* cases, clearly only applies to a settlement regarding "partnership items" and the applicability of §6621(c) is not a partnership item, nor is the applicability of the abatement provisions pursuant to I.R.C. §6404, nor is any defense based on the statute of limitations, therefore, this claim ***cannot*** be precluded by the terms of the settlement and any attempt to do so by the IRS can only be construed to be frivolous and abusive. The settlement agreement is clearly stamped as a "Consistent Agreement."

10. As an alternative, and in addition to the grounds set forth above, the taxpayer(s) are entitled to the benefit of a net rate of interest of zero pursuant to I.R.C. §6621(d) and a refund of the interest paid on the portion of the deficiency equal to the amount of any refund with respect to which the taxpayer(s) were entitled to receive interest for the periods during which interest was charged on such portion of the deficiency and is payable on such refunds. This claim constitutes the taxpayer(s)' request that the Secretary apply §6621(d) to all such periods, which includes all periods from April 15, 1994 until the date of payment of the tax sought to be refunded under this claim. A substantial overpayment occurred in 1993 resulting from the loss realized upon termination of the taxpayer(s)' Partnership interests in Richgrove Grape Associates and Desert Highland Vineyards due to the increase in the tax basis in the taxpayer(s)' Partnership interest resulting from the settlements. To the

extent of equivalent amounts of underpayments or overpayments, the periods set forth under §5.063 of Rev. Proc. 99-43 have not previously been applied to obtain a net interest rate of zero under §6621(d).

Exhibits:

A - Evidence of settlement

B - Evidence of tax assessment and payment

[MORRIS WEINER]

EXPLANATION 1984 REFUND CLAIM

This refund claim is filed based upon the following grounds:

1. An assessment of tax and interest was made relative to adjustments to partnership items and affected items related to the Travertine Flame Associates partnership for 1984 after the statute of limitations had already run. Any amount assessed and collected after the statute of limitations has run constitutes an overpayment pursuant to Internal Revenue Code Sec. 6401. The assessment was made more than three years after the partnership return was filed. There was no valid extension of the statute of limitations for the partnership known to the taxpayers. There is no applicable exception to the normal three-year statute of limitations. Any settlement upon which the assessment was based was solicited by the Internal Revenue Service and entered into utilizing a Form 870-P(AD) after the statute of limitations had expired. *Alexander v. United States*, 44 F.3d 328 (5th Cir. 1995), and *Ewing v. United States*, 914 F.2d 499 (4th Cir. 1990). The Form 870-P(AD) creating the only settlements upon which these assessments were based did not waive the statute of limitations. An extension of the statute of limitations must be pursuant to a written agreement entered into "before the expiration of such period." I.R.C. Section 6229(b)(1). See Rev. Rul. 74-580, 1974-2 C.B. 400, *Alexander, supra.; Melahn v. Commissioner*, 9 T.C. 768 (1947). No event has occurred that as a matter of law tolled the statute of limitations. (Neither an invalid FPAA nor an invalid petition filed with the Tax Court tolls the limitations period, nor does a settlement agreement entered into after the statute of limitations has expired reopen the period for assessment.) A Form 870-P(AD) provides that "no claim for refund or credit based on any change in the treatment of partnership items may be filed or prosecuted." [Emphasis added.] This claim does not seek a change in the treatment

of the partnership items. This claim concedes that the partnership items should, in fact, be adjusted as agreed on any applicable Form 870-P(AD) and it is, therefore, not necessary to show fraud, malfeasance or misrepresentation. The claim is not barred by any Form 870-P(AD) because it does not seek a change in the "treatment of partnership items."

2. Any amount assessed and collected after the statute of limitations had expired constitutes a refundable overpayment pursuant to I.R.C. Sec. 6401. *Alexander, supra; Cohen v. Commissioner* , 91-2 U.S.T.C. ¶ 50,384 (1991) *aff'd.* 995 F.2d 205 (Fed. Cir. 1993).

3. The claim is timely. It is being filed within two years from the date of payment. In the Fifth Circuit, this is the later of the date of assessment or the date of remittance. *Thomas v. Mercantile Nat'l. Bank*, 204 F.2d 206 (5th Cir. 1953). Additionally, even if any of the periods under I.R.C. Sec. 6230 apply to any portion of this claim, it is timely under those provisions as well.

4. In the alternative, even if the statute of limitations does not bar the assessment and collection of tax, taxpayers are not liable for the penalty portion of the interest paid under I.R.C. Sec, 6621(c). To the extent the tax deficiencies upon which the I.R.C. Sec. 6621(c) interest was assessed arose from agreed adjustments to partnership items, based upon an agreement under I.R.C. Sec. 6224(c), the partnership item adjustments were not based on affirmative findings by the I.R.S. but were based solely on amounts offered as adjustments by the taxpayers and accepted by the I.R.S. No trial was conducted. To the extent the deficiency is based on an I.R.C. Sec. 6224(c) agreed settlement that was entered into, such agreement provided solely for certain specific adjustments to partnership items. The assessments that resulted from an agreed settlement reflect only a concession to the partnership item adjustments which avoided the requirement of a trial on

each of the elements set out in the relevant original notice of final partnership administrative adjustment ("FPAA").

5. Additionally, or alternatively, it is clear that several of the initial proposed bases for the adjustments set forth in the original FPAA were independent of any basis that would have constituted a "tax motivated transaction." The controlling Tax Court case is *McCrary v. Commissioner,* 92 T.C. 827 (1989). This case clearly established that to the extent the taxpayers made concessions to avoid the necessity for litigation and where the basis of concession did not require the Court to determine if the adjustments were specifically "attributable to" a tax-motivated transaction, the Sec. 6621(c) penalty was inapplicable, even though some of the I.R.S.'s alternative grounds in the original FPAA for disallowance would support it! *See also Todd v. Commissioner*, 862 F.2d 540 (5th Cir. 1988). Treasury Regulation Sec. 301.6621-2T, A-5, Temporary Proced. & Admin. Regs., 49 Fed. Reg. 59394 (Dec. 28, 1984) also supports this position.

6. Alternatively, even if the doctrine under *Todd*, *McCrary*, and Treas. Reg. Sec. 301.6221-2T, A-5 does not preclude the application of I.R.C. Sec. 6221(c), no portion of the underlying tax liability was attributable to any event defined in I.R.C. Sec. 6221(c) or the regulations thereunder as a tax motivated transaction.

[M. SCOTT AND JOYCE W. KRAEMER]

EXPLANATION 1984 REFUND CLAIM

This refund claim is filed based upon the following grounds:

1. An assessment of tax and interest was made relative to adjustments to partnership items and affected items related to the Oasis Date Associates partnership for 1984 after the statute of limitations had already run. Any amount assessed and collected after the statute of limitations has run constitutes an overpayment pursuant to Internal Revenue Code §6401. The assessment was made more than three years after the relevant partnership returns were filed. There were no valid extensions of the statute of limitations for the partnership known to the taxpayers. There is no applicable exception to the normal three-year statute of limitations. Any settlements upon which the assessments were based was solicited by the Internal Revenue Service and entered into utilizing a Form 870-P(AD) after the relevant statute of limitations had expired. *Alexander v. United States*, 44 F.3d 328 (5th Cir. 1995), and *Ewing v. United States*, 914 F.2d 499 (4th Cir. 1990). The Form 870-P(AD) creating the only settlement upon which these assessments were based did not waive the statute of limitations. An extension of the statute of limitations must be pursuant to a written agreement entered into "before the expiration of such period." I.R.C. §6229(b)(1). See Rev. Rul. 74-580, 1974-2 C.B. 400, *Alexander, supra.; Melahn v. Commissioner* , 9 T.C. 768 (1947). No event has occurred that as a matter of law tolled the statute of limitations. (Neither an invalid FPAA nor an invalid petition filed with the Tax Court tolls the limitations period, nor does a settlement agreement entered into after the statute of limitations has expired reopen the period for assessment.) A Form 870-P(AD) provides that "no claim for refund or credit based on any change in the treatment of partnership items may be filed or prosecuted." [Emphasis added.] This claim does not seek a change in the

treatment of the partnership items. This claim concedes that the partnership items should, in fact, be adjusted as agreed on any applicable Forms 870-P(AD) and it is, therefore, not necessary to show fraud, malfeasance or misrepresentation. The claim is not barred by any Form 870-P(AD) because it does not seek a change in the "treatment of partnership items."

2. Any amount assessed and collected after the statute of limitations had expired constitutes a refundable overpayment pursuant to I.R.C. §6401. *Alexander, supra; Cohen v. Commissioner*, 91-2 U.S.T.C. ¶ 50,384 (1991) *aff'd.* 995 F.2d 205 (Fed. Cir. 1993).

3. The claim is timely. It is being filed within two years from the date of payment. In the Fifth Circuit, this is the later of the date of assessment or the date of remittance. *Thomas v. Mercantile Nat'l. Bank*, 204 F.2d 206 (5th Cir. 1953). Additionally, even if any of the periods under I.R.C. §6230 apply to any portion of this claim, it is timely under those provisions as well.

4. In the alternative, even if the statute of limitations does not bar the assessment and collection of tax, taxpayers are not liable for the penalty portion of the interest paid under I.R.C. §6621(c). To the extent the tax deficiencies upon which the I.R.C. §6621(c) interest was assessed arose from agreed adjustments to partnership items, based upon an agreement under I.R.C. §6224(c), the partnership item adjustments were not based on affirmative findings by the IRS but were based solely on amounts offered as adjustments by the taxpayers and accepted by the IRS. No trial was conducted. To the extent the deficiency is based on an I.R.C. §6224(c) agreed settlement that was entered into, such agreement provided solely for certain specific adjustments to partnership items. The assessment that resulted from an agreed settlement reflect only a concession to the partnership item adjustments, which avoided the requirement of a trial on each of the elements set out in the

relevant original notice of final partnership administrative adjustment ("FPAA").

5. Additionally, or alternatively, it is clear that several of the initial proposed bases for the adjustment set forth in the original FPAA were independent of any basis that would have constituted a "tax motivated transaction." The controlling Tax Court case is *McCrary v. Commissioner*, 92 T.C. 827 (1989). This case clearly established that to the extent the taxpayers made concessions to avoid the necessity for litigation and where the basis of concession did not require the Court to determine if the adjustments were specifically "IRS attributable to" a tax-motivated transaction, the §6621(c) penalty was inapplicable, even though some of the's alternative grounds in the original FPAA for disallowance would support it! *See also Todd v. Commissioner*, 862 F.2d 540 (5th Cir. 1988). Treasury Regulation §301.6621-2T, A-5, Temporary Proced. & Admin. Regs., 49 Fed. Reg. 59394 (Dec. 28, 1984) also supports this position.

6. Alternatively, even if the doctrine under *Todd*, *McCrary*, and Treas. Reg. §301.6221-2T, A-5 does not preclude the application of I.R.C. §6221(c), no portion of the underlying tax liability was attributable to any event defined in I.R.C. §6221(c) or the regulations thereunder as a tax motivated transaction.

7. Preliminary interest calculations indicate the government may have failed to take into account the doctrine in *Avon Products*, 78-2 U.S.T.C., ¶ 9821 (1978), pursuant to which it has been determined, and conceded by the government, that interest does not begin to run on a deficiency of tax until the date on which a refund was paid if no interest was paid with the original refund. This paragraph constitutes a protective claim based on those preliminary computations.

[M. SCOTT AND JOYCE W. KRAEMER]

EXPLANATION 1986 REFUND CLAIM

This refund claim is filed based upon the following grounds:

1. An assessment of tax and interest was made relative to adjustments to partnership items and affected items related to the Coachella Fruit Growers partnership for 1986 after the statute of limitations had already run. Any amount assessed and collected after the statute of limitations has run constitutes an overpayment pursuant to Internal Revenue Code §6401. The assessment was made more than three years after the partnership return was filed. There was no valid extension of the statute of limitations for the partnership known to the taxpayers. There is no applicable exception to the normal three-year statute of limitations. Any settlement upon which the assessment was based was solicited by the Internal Revenue Service and entered into utilizing a Form 870-P(AD) after the statute of limitations had expired. *Alexander v. United States*, 44 F.3d 328 (5th Cir. 1995), and *Ewing v. United States*, 914 F.2d 499 (4th Cir. 1990). The Form 870-P(AD) creating the only settlement upon which this assessment was based did not waive the statutes of limitations. An extension of the statute of limitations must be pursuant to a written agreement entered into "before the expiration of such period." I.R.C. §6229(b)(1). See Rev. Rul. 74-580, 1974-2 C.B. 400, *Alexander, supra.; Melahn v. Commissioner* , 9 T.C. 768 (1947). No event has occurred that as a matter of law tolled the statute of limitations. (Neither an invalid FPAA nor an invalid petition filed with the Tax Court tolls the limitations period, nor does a settlement agreement entered into after the statute of limitations has expired reopen the period for assessment.) A Form 870-P(AD) provides that "no claim for refund or credit based on any change in the treatment of partnership items may be filed or prosecuted." [Emphasis added.] This claim does not seek a change in the treatment of the partnership items. This

claim concedes that the partnership items should, in fact, be adjusted as agreed on any applicable Form 870-P(AD) and it is, therefore, not necessary to show fraud, malfeasance or misrepresentation. The claim is not barred by any Form 870-P(AD) because it does not seek a change in the "treatment of partnership items."

2. Any amount assessed and collected after the statute of limitations had expired constitutes a refundable overpayment pursuant to I.R.C. §6401. *Alexander, supra; Cohen v. Commissioner*, 91-2 U.S.T.C. ¶ 50,384 (1991) *aff'd.* 995 F.2d 205 (Fed. Cir. 1993).

3. The claim is timely. It is being filed within two years from the date of payment. In the Fifth Circuit, this is the later of the date of assessment or the date of remittance. *Thomas v. Mercantile Nat'l. Bank* , 204 F.2d 206 (5th Cir. 1953). Additionally, even if any of the periods under I.R.C. §6230 apply to any portion of this claim, it is timely under those provisions as well.

4. In the alternative, even if the statute of limitations does not bar the assessment and collection of tax, taxpayers are not liable for the penalty portion of the interest paid under I.R.C. §6621(c). To the extent the tax deficiencies upon which the I.R.C. §6621(c) interest was assessed arose from agreed adjustments to partnership items, based upon an agreement under I.R.C. §6224(c), the partnership item adjustments were not based on affirmative findings by the IRS but were based solely on amounts offered as adjustments by the taxpayers and accepted by the IRS. No trial was conducted. To the extent the deficiency is based on an I.R.C. §6224(c) agreed settlement that was entered into, such agreement provided solely for certain specific adjustments to partnership items. The assessment that resulted from an agreed settlement reflect only a concession to the partnership item adjustments, which avoided the requirement of a trial on each of the elements set out in the

relevant original notice of final partnership administrative adjustment ("FPAA").

5. Additionally, or alternatively, it is clear that several of the initial proposed bases for the adjustment set forth in the original FPAA were independent of any basis that would have constituted a "tax motivated transaction." The controlling Tax Court case is *McCrary v. Commissioner,* 92 T.C. 827 (1989). This case clearly established that to the extent the taxpayers made concessions to avoid the necessity for litigation and where the basis of concession did not require the Court to determine if the adjustments were specifically "attributable to" a tax-motivated transaction, the §6621(c) penalty was inapplicable, even though some of the's alternative grounds in the original FPAA for disallowance would support it! *See also Todd v. Commissioner*, 862 F.2d 540 (5th Cir. 1988). Treasury Regulation §301.6621-2T, A-5, Temporary Proced. & Admin. Regs., 49 Fed. Reg. 59394 (Dec. 28, 1984) also supports this position.

6. Alternatively, even if the doctrine under *Todd*, *McCrary*, and Treas. Reg. §301.6221-2T, A-5 does not preclude the application of I.R.C. §6221(c), no portion of the underlying tax liability was attributable to any event defined in I.R.C. §6221(c) or the regulations thereunder as a tax motivated transaction.

7. Additionally and in the alternative, even if the above doctrines do not directly apply, the result of the 870-P settlement agreement was a decrease in tax, which under no circumstances justified the assessment and collection of additional interest of $4,086.00.

8. Preliminary interest calculations indicate the government may have failed to take into account the doctrine in *Avon Products*, 78-2 U.S.T.C., ¶ 9821 (1978), pursuant to which it has been determined, and conceded by the government, that interest does not begin to run on a

deficiency of tax until the date on which a refund was paid if no interest was paid with the original refund. This paragraph constitutes a protective claim based on those preliminary computations.

AGRI-VENTURE II

EXPLANATION OF ADJUSTMENTS

I. It is determined that the farming expenses claimed on Schedule F in the amounts of $23,926,643.00 and $9,951,032.00 and Other Deductions claimed on line 22, page 1 of Form 1065 in the amounts of $416,189.00 and $313,564.00 for the taxable periods ending December 31, 1984 and December 31, 1985, respectively, are not allowable, and it is determined that cost of goods sold claimed on line 51 of Schedule F in the amount of $23,926,643.00, Ordinary income from other partnerships claimed on line 4, page 1 of Form 1065 in the amount of $(1,788,753.00), and property claimed eligible for investment credit on Form 3468 in the total amount of $160,705.00 ($3,247.00, $37,721.00, and $119,737.00) for the taxable period ending December 31, 1985, are not allowable for the following reasons:

1. The partnership's activities constitute a series of sham transactions.

2. The partnership's activities lack economic substance.

3. The partnership did not engage in the trade or business of farming during the taxable periods.

4. The partnership has not substantiated any of the expenses it claimed it paid or incurred during the taxable periods.

5. The partnership did not pay or incur any bona fide trade or business expenses during the taxable periods.

6. If it is determined that the partnership did pay or incur expenses during the taxable periods, it has not been established that the expenses paid or incurred were ordinary and necessary trade or

business expenses currently deductible under section 162 of the Internal Revenue Code and the Regulations thereunder.

7. The partnership has not substantiated its claimed cost or other basis in the alleged qualified investment property.

8. The partnership has not clearly described which property it is claiming is qualified for the investment tax credit.

II. In the alternative, if the partnership activities are determined to constitute a valid trade or business, then the following alternate positions are applicable for the taxable periods ending December 31, 1984 and December 31, 1985, unless otherwise stated in the particular numbered paragraph:

1. The partnership has not substantiated any or all items relating to the following transactions, to the extent that a determination of such items can be made from determinations that the partnership is required to make with respect to an amount, the character of an amount, or the percentage interest of a partner in the partnership, for purposes of the partnership books and records or for purposes of furnishing information to a partner:

   a. Contributions to the partnership; and

   b. Distributions from the partnership.

2. The partnership incurred no bona fide debt and made no bona fide loans with respect to its trade or business of farming.

3. Under section 704 of the Internal Revenue Code and the Regulations thereunder, a partner may not deduct partnership losses exceeding his adjusted basis in the partnership. The partnership has not

established that any of its partners signed any document or assumed the obligation contained in any document which purports to increase some or all of the partners' share of the liabilities of the partnership under section 752(a) of the Internal Revenue Code and the Regulations thereunder. For instance, the assumption agreements signed by the limited partners are not includable in their adjusted partnership bases because it has not been established that they represent the assumption of bona fide partnership liabilities as required by the provisions of section 752 of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 3 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of partners' bases which are partnership items.

4. No distributive shares of any losses from the partnership's activities are allowable because it has not been established that the partners are at risk in any amount for such activities at the close of the taxable periods, pursuant to the provisions of section 465 of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 4 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of the at risk determination which are partnership items.

5. The expenses claimed for organization of the partnership and syndication fees are not allowable because it has not been substantiated that the partnership has met all of the requirements of section 709 of the Internal Revenue Code and the

Regulations thereunder for the deduction of all or part of said claimed expenses.

6. The partnership has not substantiated that it had either investment interest or investment income as those terms are defined in section 163(d) of the Internal Revenue Code and the Regulations thereunder. Therefore, the amount of income claimed on the partnership's returns as investment income is not investment income. The only matters raised in this subparagraph 6 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of investment interest and investment income which are partnership items.

7. It has not been established that any corporation which purports to be a partner of the partnership actually was a partner in the partnership at any time during the taxable period(s) in question. Accordingly, any deferral of and adjustments to income that the partnership obtained because the partnership claimed a corporation as one of its partners is disallowed in full.

8. It has been determined that under section 752(b) of the Internal Revenue Code and the Regulations thereunder, a deemed distribution of money occured [sic] during the 1985 taxable year in the total amount of $19,141,314.00. Therefore, under section 731(a) of the Internal Revenue Code and the Regulations thereunder, gain shall be recognized by the partners to the extent that the distribution exceeds the adjusted bases of all of the partners' interests in the partnership immediately before the distribution. The only matters raised in this subparagraph 8 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of the

distribution of money and the gain to be recognized which are partnership items.

9. It has been determined that the partnership is not entitled to automatically change to the accrual method of accounting under section 447 of the Internal Revenue Code and the Regulations thereunder for the taxable period ended December 31, 1985. Because section 447 does not apply, the partnership must ask the Commissioner for permission to change its method of accounting. For the taxable period ending December 31, 1985, the partnership did not ask the Commissioner for permission to change its method of accounting from the cash basis to the accrual method of accounting, and the Commissioner has not otherwise consented to permit the partnership to change its method of accounting from the cash basis method to the accrual method of accounting. Accordingly, the taxable income of the partnership for the taxable period ending December 31, 1985, is increased due to the recomputation of taxable income using the cash basis method of accounting.

III. 1. It is determined that the Tax Preference Item of qualified investment expenses is zero in leiu [sic] of the $24,09[illegible]428.00 and $10,161,960.00 reported on the partnership tax returns for the taxable periods ending December 31, 1984 and December 31, 1985, since the expenses on which the tax preference item was based have been adjusted for the reasons stated above. Accordingly, tax preference items have been reduced $24,099,428.00 and $10,161,960.00.

2. It is determined that the Tax Preference Item of qualified investment income is zero in lieu of the $19,889.00 and $12,711,147.00 reported on the partnership tax returns for the taxable periods

ending December 31, 1984 and December 31, 1985, because the partnership has not substantiated that it had income that qualifies as investment income.

IV. It is determined that for purposes of section 6229(c) of the Internal Revenue Code, a partner has, with the intent to evade tax, signed or participated directly or indirectly in the preparation of the partnership returns each of which return includes a false or fraudulent item for the taxable periods ending December 31, 1984 and December 31, 1985.

AGRI-VENTURE FUND

EXPLANATION OF ADJUSTMENTS

I. It is determined that the farming expenses claimed on Schedule F in the amount of $27,605,580.00, Other Deductions claimed on line 22, page 1 of Form 1065 in the amount of $510,828.00, Gross Rents claimed on line 6(c), page 1 of Form 1065 in the amount of $(369,661.00), Depreciation claimed on Form 4562 in the amount of $369,661.00, Ordinary income from other partnerships claimed on line 4, page 1 of Form 1065 in the amount of $(3,724,033.00) and property claimed eligible for investment credit on Form 3468 in the total amount of $2,615,749.00, ($182,279.00, $2,418,496.00 and $14,974.00) for the taxable period ending December 31, 1985, are not allowable for the following reasons:

1. The partnership's activities constitute a series of sham transactions.

2. The partnership's activities lack economic substance.

3. The partnership did not engage in the trade or business of farming during the taxable period.

4. The partnership has not substantiated any of the expenses it claimed it paid or incurred during the taxable period.

5. The partnership did not pay or incur any bona fide trade or business expenses during the taxable period.

6. If it is determined that the partnership did pay or incur expenses during the taxable period, it has not been established that the expenses paid or incurred were ordinary and necessary trade or business expenses currently deductible under section 162 of the Internal Revenue Code and the Regulations thereunder.

7. The partnership has not substantiated its claimed cost or other basis in the alleged qualified investment property.

8. The partnership has not clearly described which property it is claiming is qualified for the investment tax credit.

9. The partnership has not established that it acquired tangible personal property or other tangible property that qualifies for the investment credit, and that such property both was placed in service during the year in question and was used in a trade or business that year.

II. In the alternative, if the partnership activities are determined to constitute a valid trade or business, then the following alternate positions are applicable for the taxable period ending December 31, 1985:

1. The partnership has not substantiated any or all items relating to the following transactions, to the extent that a determination of such items can be made from determinations that the partnership is required to make with respect to an amount, the character of an amount, or the percentage interest of a partner in the partnership, for purposes of the partnership books and records or for purposes of furnishing information to a partner:

    a. Contributions to the partnership; and

    b. Distributions from the partnership.

2. The partnership incurred no bona fide debt and made no bona fide loans with respect to its trade or business of farming.

3. Under section 704 of the Internal Revenue Code and the Regulations thereunder, a partner may not deduct partnership losses exceeding his adjusted basis in the partnership. The partnership has not

established that any of its partners signed any document or assumed the obligation contained in any document which purports to increase some or all of the partners' share of the liabilities of the partnership under section 752(a) of the Internal Revenue Code and the Regulations thereunder. For instance, the assumption agreements signed by the limited partners are not includable in their adjusted partnership bases because it has not been established that they represent the assumption of bona fide partnership liabilities as required by the provisions of section 752 of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 3 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of partners' bases which are partnership items.

4. No distributive shares of any losses from the partnership's activities are allowable because it has not been established that the partners are at risk in any amount for such activities at the close of the taxable period ending December 31, 1985, pursuant to the provisions of section 465 of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 4 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of the at risk determination which are partnership items.

5. The expenses claimed for organization of the partnership and syndication fees are not allowable because it has not been substantiated that the partnership has met all of the requirements of section 709 of the Internal Revenue Code and the

Regulations thereunder for the deduction of all or part of said claimed expenses.

6. The partnership has not substantiated that it had either investment interest or investment income as those terms are defined in section 163(d) of the Internal Revenue Code and the Regulations thereunder. Therefore, the amount of income claimed on the partnership's return for the taxable period ending December 31, 1985, as investment income is not investment income. The only matters raised in this subparagraph 6 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of investment interest and investment income which are partnership items.

7. It is determined that you have not established you own property that may be depreciated or if depreciable, what the depreciable basis in that property is. Accordingly, the entire amount of depreciation claimed as a deduction on your return is disallowed.

8. It has not been established that the fair market value(s) of the depreciable property claimed to be owned by the partnership is the amount claimed on the partnership's return for the taxable period ending December 31, 1985.

9. The partnership has not established that it was in the trade or business of renting equipment or other tangible property to itself or to anyone else. Therefore, the net income or loss claimed on Statement 2 attached to its Form 1065 for the taxable period ending December 31, 1985 is not allowable.

10. If the partnership establishes it was in the trade or business of renting equipment or other tangible

property to itself or others, the partnership is not entitled to claim it has property qalifed [sic] for investment credit because it has not met the requirements of section 46(e)(3) of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 10 of this notice of final partnership administrative adjustment wich [sic] are to be litigated at the partnership level are the components of investent [sic] credit which are partnership items.

III. 1. It is determined that the Tax Preference Item of qualified investment expenses is zero in leiu [sic] of the $28,201,208.00 reported on the partnership tax return for the period ending December 31, 1985, since the expenses on which the tax preference item was based have been adjusted for the reasons stated above. Accordingly, tax preference items have been reduced $28,201,208.00.

2. It is determined that the Tax Preference Item of qualified investment income is zero in lieu of the $33,154.00 reported on the partnership tax return for the period ending December 31, 1985, because the partnership has not substantiated that it had income that qualifies as investment income.

IV. It is determined that for purposes of section 6229(c) of the Internal Revenue Code, a partner has, with the intent to evade tax, signed or participated directly or indirectly in the preparation of the partnership return which includes a false or fraudulent item for the taxable period ending December 31, 1985.

DESERT HIGHLAND VINEYARDS

EXPLANATION OF ADJUSTMENTS

I. It is determined that the farming expenses claimed on Schedule F in the amount of $3,377,028.00, Other Deductions claimed on line 22, page 1 of Form 1065 in the amount of $92,085.00, and property claimed eligible for investment credit on Form 3468 in the amount of $125,000.00, for the taxable period ending December 31, 1985, are not allowable for the following reasons:

1. The partnership's activities constitute a series of sham transactions.

2. The partnership's activities lack economic substance.

3. The partnership did not engage in the trade or business of farming during the taxable period.

4. The partnership has not substantiated any of the expenses it claimed it paid or incurred during the taxable period.

5. The partnership did not pay or incur any bona fide trade or business expenses during the taxable period.

6. If it is determined that the partnership did pay or incur expenses during the taxable period, it has not been established that the expenses paid or incurred were ordinary and necessary trade or business expenses currently deductible under section 162 of the Internal Revenue Code and the Regulations thereunder.

7. The partnership has not substantiated its claimed cost or other basis in the alleged qualified investment property.

8. The partnership has not clearly described which property it is claiming is qualified for the investment tax credit.

9. The partnership has not established that it acquired tangible personal property or other tangible property that qualifies for the investment credit, and that such property both was placed in service during the year in question and was used in a trade or business that year

II. In the alternative, if the partnership activities are determined to constitute a valid trade or business, then the following alternate positions are applicable for the taxable period ending December 31, 1985:

1. The partnership has not substantiated any or all items relating to the following transactions, to the extent that a determination of such items can be made from determinations that the partnership is required to make with respect to an amount, the character of an amount, or the percentage interest of a partner in the partnership, for purposes of the partnership books and records or for purposes of furnishing information to a partner:

   a. Contributions to the partnership; and

   b. Distributions from the partnership.

2. The partnership incurred no bona fide debt and made no bona fide loans with respect to its trade or business of farming.

3. Under section 704 of the Internal Revenue Code and the Regulations thereunder, a partner may not deduct partnership losses exceeding his adjusted basis in the partnership. The partnership has not established that any of its partners signed any document or assumed the obligation contained in any document which purports to increase some or

all of the partners' share of the liabilities of the partnership under section 752(a) of the Internal Revenue Code and the Regulations thereunder. For instance, the assumption agreements signed by the limited partners are not includable in their adjusted partnership bases because it has not been established that they represent the assumption of bona fide partnership liabilities as required by the provisions of section 752 of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 3 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of partners' bases which are partnership items.

4. No distributive shares of any losses from the partnership's activities are allowable because it has not been established that the partners are at risk in any amount for such activities at the close of the taxable period ending December 31, 1985, pursuant to the provisions of section 465 of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 4 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of the at risk determination which are partnership items.

5. The expenses claimed for organization of the partnership and syndication fees are not allowable because it has not been substantiated that the partnership has met all of the requirements of section 709 of the Internal Revenue Code and the Regulations thereunder for the deduction of all or part of said claimed expenses.

6. The partnership has not substantiated that it had either investment interest or investment income as

those terms are defined in section 163(d) of the Internal Revenue Code and the Regulations thereunder. Therefore, the amount of income claimed on the partnership's return for the taxable period ending December 31, 1985, as investment income is not investment income. The only matters raised in this subparagraph 6 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of investment interest and investment income which are partnership items.

7. It is determined that you have not established you own property that may be depreciated or if depreciable, what the depreciable basis in that property is. Accordingly, the entire amount of depreciation claimed as a deduction on your return is disallowed.

8. It has not been established that the fair market value(s) of the depreciable property claimed to be owned by the partnership is the amount claimed on the partnership's return for the taxable period ending December 31, 1985.

III. 1. It is determined that the Tax Preference Item of qualified investment expenses is zero in leiu [sic] of the $3,434,422.00 reported on the partnership tax return for the period ending December 31, 1985, since the expenses on which the tax preference item was based have been adjusted for the reasons stated above. Accordingly, tax preference items have been reduced $3,434,422.00.

2. It is determined that the Tax Preference Item of qualified investment income is zero in lieu of the $3,745.00 reported on the partnership tax return for the period ending December 31, 1985, because

the partnership has not substantiated that it had income that qualifies as investment income.

IV. It is determined that for purposes of section 6229(c) of the Internal Revenue Code, a partner has, with the intent to evade tax, signed or participated directly or indirectly in the preparation of the partnership return which includes a false or fraudulent item for the taxable period ending December 31, 1985.

RICHGROVE GRAPE ASSOCIATES

EXPLANATION OF ADJUSTMENTS

It is determined that the farming expenses claimed on Schedule F in the amounts of $4,766,893.00 and $1,950,621.00 and the Other Deductions claimed on line 22, page 1 of Form 1065 in the amounts of $121,027.00 and $117,901.00 for the taxable periods ending December 31, 1984 and December 31, 1985, respectively, are not allowable and it is determined that cost of goods sold claimed on line 51 of Schedule F in the amount of $4,766,893.00 and property claimed eligible for ivestment [sic] credit on Form 3468 in the amount of $125,000.00 for the taxable period ending December 31, 1985, are not allowable for the following reasons:

1. The partnership's activities constitute a series of sham transactions.

2. The partnership's activities lack economic substance.

3. The partnership did not engage in the trade or business of farming during the taxable periods.

4. The partnership has not substantiated any of the expenses it claimed it paid or incurred during the taxable periods.

5. The partnership did not pay or incur any bona fide trade or business expenses during the taxable periods.

6. If it is determined that the partnership did pay or incur expenses during the taxable periods, it has not been established that the expenses paid or incurred were ordinary and necessary trade or business expenses currently deductible under section 162 of the Internal Revenue Code and the Regulations thereunder.

7. The partnership has not substantiated its claimed cost or other basis in the alleged qualified investment property.

8. The partnership has not clearly described which property it is claiming is qualified for the investment tax credit.

9. The partnership has not established that it acquired tangible personal property or other tangible property that qualifies for the investment credit, and that such property both was placed in service during the year in question and was used in a trade or business that year.

In the alternative, if the partnership activities are determined to constitute a valid trade or business, then the following alternate positions are applicable for the taxable years ending December 31, 1984 and December 31, 1985, unless otherwise stated in the particular numbered paragraph:

1. The partnership has not substantiated any or all items relating to the following transactions, to the extent that a determination of such items can be made from determinations that the partnership is required to make with respect to an amount, the character of an amount, or the percentage interest of a partner in the partnership, for purposes of the partnership books and records or for purposes of furnishing information to a partner:

    a. Contributions to the partnership; and

    b. Distributions from the partnership.

2. The partnership incurred no bona fide debt and made no bona fide loans with respect to its trade or business of farming.

3. Under section 704 of the Internal Revenue Code and the Regulations thereunder, a partner may not deduct partnership losses exceeding his adjusted basis in the partnership. The partnership has not established that any of its partners signed any document or assumed the obligation contained in any document which purports to increase some or all of the partners [sic] share of the liabilities of the partnership under section 752(a) of the Internal Revenue Code and the Regulations thereunder. For instance, the assumption agreements signed by the limited partners are not includable in their adjusted partnership bases because it has not been established that they represent the assumption of bona fide partnership liabilities as required by the provisions of section 752 of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 3 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of partners' bases which are partnership items.

4. No distributive shares of any losses from the partnership's activities are allowable because it has not been established that the partners are at risk in any amount for such activities at the close of the taxable periods ending December 31, 1984 and December 31, 1985, pursuant to the provisions of section 465 of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 4 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of the at risk determination which are partnership items.

5. The expenses claimed for organization of the partnership and syndication fees are not allowable because it has not been substantiated that the partnership has met all of the requirements of section 709 of the Internal Revenue Code and the Regulations thereunder for the deduction of all or part of said claimed expenses.

6. The partnership has not substantiated that it had either investment interest or investment income as those terms are defined in section 163(d) of the Internal Revenue Code and the Regulations thereunder. Therefore, the amounts of income claimed on the partnership's returns for the taxable periods ending December 31, 1984 and December 31, 1985, as investment income are not investment income. The only matters raised in this subparagraph 6 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of investment interest and investment income which are partnership items.

7. It has not been established that any corporation which purports to be a partner of the partnership actually was a partner in the partnership at any time during the taxable period(s) in question. Accordingly, any deferral of and adjustments to income that the partnership obtained because the partnership claimed a corporation as one of its partners is disallowed in full.

8. It has been determined that under section 752(b) of the Internal Revenue Code and the Regulations thereunder, a deemed distribution of money occured [sic] during the 1985 taxable year in the total amount of $3,813,514.00. Therefore, under section 731(a) of the Internal Revenue Code and the Regulations thereunder, gain shall be recognized by

the partners to the extent that the distribution exceeds the adjusted bases of all of the partners' interests in the partnership immediately before the distribution. The only matters raised in this subparagraph 8 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of the distribution of money and the gain to be recognized which are partnership items.

9. It has been determined that the partnership is not entitled to automatically change to the accrual method of accounting under section 447 of the Internal Revenue Code and the Regulations thereunder for the taxable period ended December 31, 1985. Because section 447 does not apply, the partnership must ask the Commissioner for permission to change its method of accounting. For the taxable period ending December 31, 1985, the partnership did not ask the Commissioner for permission to change its method of accounting from the cash basis to the accrual method of accounting, and the Commissioner has not otherwise consented to permit the partnership to change its method of accounting from the cash basis method to the accrual method of accounting. Accordingly, the taxable income of the partnership for the taxable period ending December 31, 1985, is increased due to the recomputation of taxable income using the cash basis method of accounting.

10. It is determined that you have not established you own property that may be depreciated or if depreciable, what the depreciable basis in that property is. Accordingly, the entire amount of depreciation claimed as a deduction on your return is disallowed.

11. It has not been established that the fair market value(s) of the depreciable property claimed to be owned by the partnership is the amount claimed on the partnership's return for the taxable period ending December 31, 1985.

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It is determined that the Tax Preference Item of qualified investment expenses is zero in leiu [sic] of the $4,839,046.00 and $2,047,839.00 reported on the partnership tax returns for the periods ending December 31, 1984 and December 31, 1985, since the expenses on which the tax preference item was based have been adjusted for the reasons stated above. Accordingly, tax preference items have been reduced $4,839,046.00 and $2,047,839.00

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It is determined that the Tax Preference Item of qualified investment income is zero in lieu of the $8,668.00 and $1,940,175.00 reported on the partnership tax returns for the periods ending December 31, 1984 and December 31, 1985, because the partnership has not substantiated that it had income that qualifies as investment income.

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It is determined that for purposes of section 6229(c) of the Internal Revenue Code, a partner has, with the intent to evade tax, signed or participated directly or indirectly in the preparation of the partnership returns each of which return includes a false or fraudulent item for the taxable periods ending December 31, 1984 and December 31, 1985.

TRAVERTINE FLAME ASSOCIATES

EXPLANATION OF ADJUSTMENTS

It is determined that the farming expenses claimed on Schedule F in the amounts of $12,825,506.00 and $5,582,371.00 and the Other Deductions claimed on line 22, page 1 of Form 1065 in the amounts of $317,395.00 and $279,157.00 for the taxable periods ending December 31, 1984 and December 31, 1985, respectively, are not allowable and it is determined that cost of goods sold claimed on line 51 of Schedule F in the amount of $12,825,506.00 and taxes expense claimed on line 16, page 1 of Form 1065 in the amount of $6,784.00 for the taxable period ending December 31, 1985, are not allowable for the following reasons:

1. The partnership's activities constitute a series of sham transactions.

2. The partnership's activities lack economic substance.

3. The partnership did not engage in the trade or business of farming during the taxable periods.

4. The partnership has not substantiated any of the expenses it claimed it paid or incurred during the taxable periods.

5. The partnership did not pay or incur any bona fide trade or business expenses during the taxable periods.

6. If it is determined that the partnership did pay or incur expenses during the taxable periods, it has not been established that the expenses paid or incurred were ordinary and necessary trade or business expenses currently deductible under section 162 of the Internal Revenue Code and the Regulations thereunder.

In the alternative, if the partnership activities are determined to constitute a valid trade or business, then the following alternate positions are applicable for the taxable years ending December 31, 1984 and December 31, 1985, unless otherwise stated in the particular numbered paragraph:

1. The partnership has not substantiated any or all items relating to the following transactions, to the extent that a determination of such items can be made from determinations that the partnership is required to make with respect to an amount, the character of an amount, or the percentage interest of a partner in the partnership, for purposes of the partnership books and records or for purposes of furnishing information to a partner:

    a. Contributions to the partnership; and

    b. Distributions from the partnership.

2. The partnership incurred no bona fide debt and made no bona fide loans with respect to its trade or business of farming.

3. Under section 704 of the Internal Revenue Code and the Regulations thereunder, a partner may not deduct partnership losses exceeding his adjusted basis in the partnership. The partnership has not established that any of its partners signed any document or assumed the obligation contained in any document which purports to increase some or all of the partners [sic] share of the liabilities of the partnership under section 752(a) of the Internal Revenue Code and the Regulations thereunder. For instance, the assumption agreements signed by the limited partners are not includable in their adjusted partnership bases because it has not been established that they represent the assumption of bona fide partnership liabilities as required by the

provisions of section 752 of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 3 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of partners' bases which are partnership items.

4. No distributive shares of any losses from the partnership's activities are allowable because it has not been established that the partners are at risk in any amount for such activities at the close of the taxable periods ending December 31, 1984 and December 31, 1985, pursuant to the provisions of section 465 of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 4 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of the at risk determination which are partnership items.

5. The expenses claimed for organization of the partnership and syndication fees are not allowable because it has not been substantiated that the partnership has met all of the requirements of section 709 of the Internal Revenue Code and the Regulations thereunder for the deduction of all or part of said claimed expenses.

6. The partnership has not substantiated that it had either investment interest or investment income as those terms are defined in section 163(d) of the Internal Revenue Code and the Regulations thereunder. Therefore, the amounts of income claimed on the partnership's returns for the taxable periods ending December 31, 1984 and December 31, 1985, as investment income is not investment income. The only matters raised in this

subparagraph 6 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of investment interest and investment income which are partnership items.

7. It has not been established that any corporation which purports to be a partner of the partnership actually was a partner in the partnership at any time during the taxable period(s) in question. Accordingly, any deferral of and adjustments to income that the partnership obtained because the partnership claimed a corporation as one of its partners is disallowed in full.

8. It has been determined that under section 752(b) of the Internal Revenue Code and the Regulations thereunder, a deemed distribution of money occurred during the 1985 taxable year in the total amount of $10,260,405.00. Therefore, under section 731(a) of the Internal Revenue Code and the Regulations thereunder, gain shall be recognized by the partners to the extent that the distribution exceeds the adjusted bases of all of the partners' interests in the partnership immediately before the distribution. The only matters raised in this subparagraph 8 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of the distribution of money and the gain to be recognized which are partnership items.

9. It has been determined that the partnership is not entitled to automatically change to the accrual method of accounting under section 447 of the Internal Revenue Code and the Regulations thereunder for the taxable period ended December 31, 1985. Because section 447 does not apply, the partnership must ask the Commissioner for

permission to change its method of accounting. For the taxable period ending December 31, 1985, the partnership did not ask the Commissioner for permission to change its method of accounting from the cash basis to the accrual method of accounting, and the Commissioner has not otherwise consented to permit the partnership to change its method of accounting from the cash basis method to the accrual method of accounting. Accordingly, the taxable income of the partnership for the taxable period ending December 31, 1985, is increased due to the recomputation of taxable income using the cash basis method of accounting.

****

It is determined that the Tax Preference Item of qualified investment expenses is zero in lieu of the $13,011,485.00 and $5,809,635.00 reported on the partnership tax returns for the periods ending December 31, 1984 and December 31, 1985, since the expenses on which the tax preference item was based have been adjusted for the reasons stated above. Accordingly, tax preference items have been reduced $13,011,485.00 and $5,809,635.00.

****

It is determined that the Tax Preference Item of qualified investment income is zero in lieu of the $15,308.00 and $6,646,840.00 reported on the partnership tax returns for the taxable periods ending December 31, 1984 and December 31, 1985, because the partnership has not substantiated that it had income that qualifies as investment income.

****

It is determined that for purposes of section 6229(c) of the Internal Revenue Code, a partner has, with the intent to evade tax, signed or participated directly or indirectly in the

preparation of the partnership returns each of which return includes a false or fraudulent item for the taxable periods ending December 31, 1984 and December 31, 1985.

COACHELLA FRUIT GROWERS

EXPLANATION OF ADJUSTMENTS

It is determined that the farming expenses claimed on Schedule F in the amount of $7,832,935.00 and the Other Deductions claimed on line 22, page 1 of Form 1065 in the amount of $208,526.00 (totalling [sic] $8,041,461.00), for the taxable period ending November 30, 1986 are not allowable for the following reasons:

1. The partnership's activities constituted a series of sham transactions lacking economic substance.

2. The partnership did not actively engage in the trade or business of farming during the taxable period.

3. The partnership did not pay or incur any bona fide trade or business expenses during the taxable period, or if the partnership did pay or incur any expenses during the taxable period, it has not been established that they were ordinary and necessary trade or business expenses currently deductible under section 162 of the Internal Revenue Code (IRC) and the Regulations thereunder.

In the alternative, if the partnership activities are determined to constitute a valid trade or business, then the following alternate positions are applicable:

1. No distributive share of any losses from such activity are allowable to the partners because it has not been established that the partners were at risk in any amount for such activities at the close of the taxable year pursuant to the provisions of IRC section 465.

2. Under IRC section 704 a partner may not deduct partnership losses exceeding his adjusted basis in the partnership. The assumption agreements signed by the limited partners are not includable in their adjusted partnership basis because it has not been established that they represent the assumption of bona fide

partnership liabilities as required by the provisions of IRC section 752.

****

It is determined that the Tax Preference Item of qualified investment expenses is zero in lieu of the $7,961,039.00 as reported on the partnership tax return for the period ending November 30, 1986 since the expenses on which the tax preference item was based have been adjusted for the reasons stated above. Accordingly, tax preference items have been reduced $7,961,039.00.

OASIS DATE ASSOCIATES

EXPLANATION OF ADJUSTMENTS

It is determined that the farming expenses claimed on Schedule F in the amounts of $4,696,859.00 and $905,590.00 and Other Deductions claimed on line 22, page 1 of Form 1065 in the amounts of $113,071.00 and $103,346.00 for the taxable periods ending December 31, 1984 and December 31, 1985, respectively, are not allowable and it is determined that interest expense claimed on line 15c, page 1 of Form 1065 in the amount of $288.00 for the taxable period ending December 31, 1984 and cost of goods sold claimed on line 51 of Schedule F in the amount of $4,696,859.00 and property claimed eligible for investment credit on Form 3468 in the amount of $125,000.00 for the taxable period ending December 31, 1985, are not allowable for the following reasons:

1. The partnership's activities constitute a series of sham transactions.

2. The partnership's activities lack economic substance.

3. The partnership did not engage in the trade or business of farming during the taxable periods.

4. The partnership has not substantiated any of the expenses it claimed it paid or incurred during the taxable periods.

5. The partnership did not pay or incur any bona fide trade or business expenses during the taxable periods.

6. If it is determined that the partnership did pay or incur expenses during the taxable periods, it has not been established that the expenses paid or incurred were ordinary and necessary trade or business expenses currently deductible under

section 162 of the Internal Revenue Code and the Regulations thereunder.

7. The partnership has not substantiated its claimed cost or other basis in the alleged qualified investment property.

8. The partnership has not clearly described which property it is claiming is qualified for the investment tax credit.

9. The partnership has not established that it acquired tangible personal property or other tangible property that qualifies for the investment credit, and that such property both was placed in service during the year in question and was used in a trade or business that year.

In the alternative, if the partnership activities are determined to constitute a valid trade or business, then the following alternate positions are applicable for the taxable years ending December 31, 1984 and December 31, 1985, unless otherwise stated in the particular numbered paragraph:

1. The partnership has not substantiated any or all items relating to the following transactions, to the extent that a determination of such items can be made from determinations that the partnership is required to make with respect to an amount, the character of an amount, or the percentage interest of a partner in the partnership, for purposes of the partnership books and records or for purposes of furnishing information to a partner:

    a. Contributions to the partnership; and

    b. Distributions from the partnership.

2. The partnership incurred no bona fide debt and made no bona fide loans with respect to its trade or business of farming.

3. Under section 704 of the Internal Revenue Code and the Regulations thereunder, a partner may not deduct partnership losses exceeding his adjusted basis in the partnership. The partnership has not established that any of its partners signed any document or assumed the obligation contained in any document which purports to increase some or all of the partners [sic] share of the liabilities of the partnership under section 752(a) of the Internal Revenue Code and the Regulations thereunder. For instance, the assumption agreements signed by the limited partners are not includable in their adjusted partnership bases because it has not been established that they represent the assumption of bona fide partnership liabilities as required by the provisions of section 752 of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 3 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of partners' bases which are partnership items.

4. No distributive shares of any losses from the partnership's activities are allowable because it has not been established that the partners are at risk in any amount for such activities at the close of the taxable periods ending December 31, 1984 and December 31, 1985, pursuant to the provisions of section 465 of the Internal Revenue Code and the Regulations thereunder. The only matters raised in this subparagraph 4 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the

components of the at risk determination which are partnership items.

5. The expenses claimed for organization of the partnership and syndication fees are not allowable because it has not been substantiated that the partnership has met all of the requirements of section 709 of the Internal Revenue Code and the Regulations thereunder for the deduction of all or part of said claimed expenses.

6. The partnership has not substantiated that it had either investment interest or investment income as those terms are defined in section 163(d) of the Internal Revenue Code and the Regulations thereunder. Therefore, the amounts of income claimed on the partnership's returns for the taxable periods ending December 31, 1984 and December 31, 1985, as investment income are not investment income. The only matters raised in this subparagraph 6 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of investment interest and investment income which are partnership items.

7. It has not been established that any corporation which purports to be a partner of the partnership actually was a partner in the partnership actually was a partner in the partnership at any time during the taxable period(s) in question. Accordingly, any deferral of and adjustments to income that the partnership obtained because the partnership claimed a corporation as one of its partners is disallowed in full.

8. It has been determined that under section 752(b) of the Internal Revenue Code and the Regulations thereunder, a deemed distribution of money

occurred during the 1985 taxable year in the total amount of $3,757,554.00. Therefore, under section 731(a) of the Internal Revenue Code and the Regulations thereunder, gain shall be recognized by the partners to the extent that the distribution exceeds the adjusted bases of all of the partners' interests in the partnership immediately before the distribution. The only matters raised in this subparagraph 6 of this notice of final partnership administrative adjustment which are to be litigated at the partnership level are the components of the distribution of money and the gain to be recognized which are partnership items.

9. It has been determined that the partnership is not entitled to automatically change to the accrual method of accounting under section 447 of the Internal Revenue Code and the Regulations thereunder for the taxable period ended December 31, 1985. Because section 447 does not apply, the partnership must ask the Commissioner for permission to change its method of accounting. For the taxable period ending December 31, 1985, the partnership did not ask the Commissioner for permission to change its method of accounting from the cash basis method to the accrual method of accounting, and the Commissioner has not otherwise consented to permit the partnership to change its method of accounting from the cash basis method to the accrual method of accounting. Accordingly, the taxable income of the partnership for the taxable period ending December 31, 1985, is increased due to the recomputation of taxable income using the cash basis method of accounting.

10. It is determined that you have not established you own property that may be depreciated or if depreciable, what the depreciable basis in that

property is. Accordingly, the entire amount of depreciation claimed as a deduction on your return is disallowed.

11. It has not been established that the fair market value(s) of the depreciable property claimed to be owned by the partnership is the amount claimed on the partnership's return for the taxable period ending December 31, 1985.

****

It is determined that the Tax Preference Item of qualified investment expenses is zero in leiu [sic] of the $4,762,115.00 and $998,848.00 reported on the partnership tax returns for the periods ending December 31, 1984 and December 31, 1985, since the expenses on which the tax preference item was based have been adjusted for the reasons stated above. Accordingly, tax preference items have been reduced $4,762,115.00 and $998,848.00.

****

It is determined that the Tax Preference Item of qualified investment income is zero in lieu of the $23,952.00 and $1,108,750.00 reported on the partnership tax returns for the periods ending December 31, 1984 and December 31, 1985, because the partnership has not substantiated that it had income that qualifies as investment income.

****

It is determined that for purposes of section 6229(c) of the Internal Revenue Code, a partner has, with the intent to evade tax, signed or participated directly or indirectly in the preparation of the partnership returns each of which return includes a false or faudulent [sic] item for the taxable periods ending December 31, 1984 and December 31, 1985.

Supreme Court, U.S.
FILED
AUG 17 2009
OFFICE OF THE CLERK

No. 08-1546

In the Supreme Court of the United States

KENNETH C. KEENER, WILLIAM P. SMITH, AND ANNE D. SMITH, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

Petitioners filed suit for refunds of federal income tax in connection with their investments in tax-shelter partnerships. Under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), the proper tax treatment of partnership items is determined at the partnership level in a unified audit and judicial proceeding. TEFRA further provides that individual partner-level suits may not be brought for tax refunds "attributable to partnership items." 26 U.S.C. 7422(h). The questions presented are as follows:

1. Whether the Court of Federal Claims correctly declined to entertain petitioners' refund action challenging the assessment of interest under now-repealed 26 U.S.C. 6621(c) (1988) for the partnerships' tax motivated transactions.

2. Whether the Court of Federal Claims correctly declined to entertain petitioners' refund action challenging the timeliness of the assessments of tax and interest attributable to partnership items.

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In the Supreme Court of the United States

No. 08-1546

KENNETH C. KEENER, WILLIAM P. SMITH, AND ANNE D. SMITH, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-17) is reported at 551 F.3d 1358. The opinion of the Court of Federal Claims (Pet. App. 18-50) is reported at 76 Fed. Cl. 455.

JURISDICTION

The judgment of the court of appeals was entered on January 8, 2009. A petition for rehearing was denied on March 18, 2009 (Pet. App. 163-164). The petition for a writ of certiorari was filed on June 16, 2009. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. To achieve consistent tax treatment of all partners in the same partnership and to remove the substan-

tial administrative burden occasioned by duplicative audits and litigation, Congress enacted coordinated procedures for determining the proper treatment of "partnership items" at the partnership level in a single, unified audit and judicial proceeding. See Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, § 402(a), 96 Stat. 648; H.R. Conf. Rep. No. 760, 97th Cong., 2d Sess. 599-600 (1982). TEFRA defines the term "partnership item" as—

> any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

26 U.S.C. 6231(a)(3). Regulations promulgated under Section 6231(a)'s grant of rulemaking authority provide that the term "partnership item" includes "the legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc." 26 C.F.R. 301.6231(a)(3)-1(b).

When the Internal Revenue Service (IRS) disagrees with a partnership's reporting of any partnership item, it must issue a Notice of Final Partnership Administrative Adjustment (FPAA) before making against the partners any assessments attributable to that item. 26 U.S.C. 6223(a)(2) and (d)(2), 6225(a). If a petition contesting adjustments in an FPAA is filed, all partners with interests in the outcome are treated as parties (26 U.S.C. 6226(c) and (d)), and the court has jurisdiction to determine all partnership items to which the FPAA relates (26 U.S.C. 6226(f)).

As part of TEFRA, Congress enacted the provision codified at 26 U.S.C. 7422(h). TEFRA § 402(c)(11), 96 Stat. 668. Section 7422(h), as relevant here, precludes any action for a tax refund "attributable to partnership items."[1] The statutory scheme provides instead that tax treatment of any partnership item "shall be determined at the partnership level." 26 U.S.C. 6221. Accordingly, partners who intend to contest partnership items may do so only in the unified partnership proceeding, where the court "shall have jurisdiction to determine all partnership items of the partnership." 26 U.S.C. 6226(f).

2. a. Petitioners invested in limited partnerships promoted by AMCOR, a California corporation that "was in the business of promoting tax shelter partnerships" during the early to mid-1980s. Pet. App. 3. Petitioners reported their distributive shares of partnership losses on their 1984 and 1985 individual income tax returns and used those losses to offset their taxable income in those years. *Ibid.* The IRS examined the partnerships' tax returns and issued an FPAA to each partnership in 1991. *Ibid.* The FPAAs disallowed the loss deductions reported by the partnerships in 1984 and 1985 and, accordingly, reduced those deductions to zero. *Ibid.* Each FPAA stated that the deductions were not allowable because, *inter alia*, "[t]he partnership's activities constitute a series of sham transactions." *Ibid.*

---

[1] Section 7422(h) states:

> No action may be brought for a refund attributable to partnership items (as defined in section 6231(a)(3)) except as provided in section 6228(b) or section 6230(c).

26 U.S.C. 7422(h). Petitioners do not contend that either specified exception applies here.

In response, certain partners filed petitions in the Tax Court for readjustment of partnership items pursuant to 26 U.S.C. 6226. Pet. App. 3. In those petitions, the partners claimed that the period for assessing tax attributable to the adjusted partnership items had expired prior to issuance of the FPAAs and that the IRS had erred in determining that the partnerships' activities constituted a series of sham transactions. *Ibid.* Because petitioners were partners in the partnerships, they automatically became parties to the suit. See 26 U.S.C. 6226(c).

While the partnership proceedings were pending in the Tax Court, petitioners settled some of their disputed partnership items with the IRS. Pet. App. 4. In the settlement agreements, petitioners were permitted to report a portion of the previously disallowed deductions. *Ibid.* In return, petitioners agreed to waive the restrictions on the assessment and collection of any deficiency attributable to partnership items and also agreed that they would not file any refund claim based on any change in the treatment of partnership items. *Id.* at 4, 36. Petitioners further agreed that the settlements "may result in an additional tax liability to [them] plus interest as provided by law." *Id.* at 4. The IRS subsequently assessed the additional tax and interest now at issue, including interest at the enhanced rate for substantial underpayment attributable to tax motivated transactions under now-repealed 26 U.S.C. 6621(c) (1988) (former Section 6621(c)).[2]

The Tax Court issued stipulated decisions in the partnership proceedings in 2001. Pet. App. 4 n.2. Those

[2] The court of appeals referred to former Section 6621(c) interest as "penalty interest," Pet. App. 4, but this brief hereinafter refers to it as "tax motivated interest."

decisions stated that the adjustments to partnership income and expense were attributable to transactions that lacked economic substance as described in former 26 U.S.C. 6621(c)(3)(A)(v) (1988). Pet. App. 4 n.2. The decisions also stated that the assessment of any deficiencies in income tax attributable to the adjustments to partnership items was not time barred by 26 U.S.C. 6229. Pet. App. 4 n.2.

Petitioners separately filed administrative refund claims with the IRS. Pet. App. 4. Petitioners asserted that their settlement agreements and the resulting assessments had been made after the statute of limitations had expired, and, alternatively, that they were not liable for tax motivated interest under former Section 6621(c). *Id.* at 188-209. The IRS denied the claims. *Id.* at 4.

b. Petitioners commenced separate refund actions in the Court of Federal Claims, and the suits were consolidated. Pet. App. 4. The government filed a motion for partial dismissal, arguing that 26 U.S.C. 7422(h), which prohibits actions for refunds "attributable to partnership items," deprived the court of subject-matter jurisdiction.

The Court of Federal Claims granted the government's motion. Pet. App. 18-50. The court held that, under the TEFRA partnership rules, petitioners were not permitted to raise their limitations defense in a partner-level refund suit like this one. *Id.* at 26-41. The court explained that because petitioners' argument required a construction of 26 U.S.C. 6229(a), which extends the limitations period of 26 U.S.C. 6501(a) for assessing any tax attributable to partnership items, it involves a partnership item that may be raised only in the unified partnership proceeding. Pet. App. 27-28. In the alternative, the court held that petitioners had waived their limita-

tions defense in their settlement agreements. *Id.* at 32-33. The court observed that a "legion of decisions" uniformly had concluded that because the limitations issue affects the partnership as a whole, it cannot be litigated in an individual partner proceeding. *Id.* at 34-35.

The Court of Federal Claims also held that petitioners were barred from challenging the assessment of tax-motivated interest in their partner-level refund suit. Pet. App. 48-49. The court explained that imposition of interest under former Section 6621(c) depended upon the nature of the partnerships' transactions, which itself presents a partnership item. *Id.* at 44-47. The court stated that where, as here, the interest was imposed because the partnerships had conducted sham transactions, resolution of whether a transaction was a sham must occur in the partnership proceeding rather than in partner-level refund suits. *Id.* at 48-50. After the parties stipulated to the dismissal of the remaining issues, the court entered final judgment. *Id.* at 4.

c. The court of appeals affirmed. Pet. App. 1-17. The court found that 26 U.S.C. 6231(a)(3), which defines the term "partnership item," did not unambiguously resolve whether petitioners' limitations claim was a partnership item. Pet. App. 9. The court accordingly gave deference, under the principles announced in *Chevron U.S.A. Inc.* v. *NRDC*, 467 U.S. 837, 843 (1984), to the agency interpretation of that provision reflected in 26 C.F.R. 301.6231(a)(3)-1(b). Pet. App. 9-10. The court concluded that petitioners' limitations claim was a partnership item because it was among the "legal and factual determinations that underlie the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc." of the partnership. *Id.* at 7 (quoting 26 C.F.R. 301.6231(a)(3)-1(b)); see *id.* at 9-

10. The court therefore held that Section 7422(h) barred the Court of Federal Claims from hearing petitioners' limitations claim in a partner-level refund suit. *Id.* at 11. The court explained that because the limitations claim affects the partnership as a whole, a contrary result would undermine TEFRA's goal of centralizing the treatment of partnership items and ensuring the equal treatment of partners. *Id.* at 10.

The court of appeals also held that the Court of Federal Claims lacked jurisdiction over petitioners' claims for a refund of tax motivated interest. Pet. App. 11-16. The court observed that the FPAAs had disallowed the partnerships' deductions based on, *inter alia*, the IRS's determination that the partnerships' transactions were shams. *Id.* at 12. The court noted as well that petitioners' settlement agreements with the IRS did not alter that determination. *Id.* at 15-16. Former Section 6621(c), the court explained, expressly provided that a "sham" transaction was subject to tax motivated interest. *Id.* at 12, 16. The court of appeals agreed with the Court of Federal Claims that the characterization of a partnership's transactions—including the determination whether a partnership transaction is a sham—is a partnership item. *Id.* at 14. Because petitioners' claim for refund of tax motivated interest was based on the assertion that the partnerships' transactions were not shams, the court concluded, that claim was barred by Section 7422(h). *Id.* at 13-14.

ARGUMENT

1. Petitioners contend (Pet. 7-24) that, notwithstanding 26 U.S.C. 7422(h), the Court of Federal Claims was authorized to consider their suit for refund of tax motivated interest assessed under 26 U.S.C. 6621(c)

(1988). The court of appeals correctly rejected that argument. In any event, because former Section 6621(c) was repealed in 1989, the issue is of minimal prospective importance. Further review is therefore not warranted.

a. Former Section 6621(c) was added to the Internal Revenue Code in 1984 to discourage the proliferation of abusive tax shelters. See Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 144(a), 98 Stat. 682; Staff of the Joint Comm. on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, at 485-486 (1984).[3] It increased the interest rate on substantial underpayments of tax attributable to "tax motivated transactions" to 120% of the otherwise applicable rate. Former Section 6621(c)(3)(A)(v) defined the term "tax motivated transaction" to include "any sham or fraudulent transaction." A "substantial underpayment" was any underpayment exceeding $1000 per tax year.

Former Section 6621(c) was repealed by the Omnibus Budget Reconciliation Act of 1989 (OBRA), Pub. L. No. 101-239, § 7721(b), 103 Stat. 2399. It was one of several provisions for which OBRA substituted a single accuracy-related penalty. See § 7721(a), 103 Stat. 2399; H.R. Rep. No. 247, 101st Cong., 1st Sess. 1388-1394 (1989). The repeal was effective for tax returns due after December 31, 1989. See OBRA § 7721(d), 103 Stat. 2400.

b. The court of appeals correctly concluded that petitioners were barred from challenging in this refund suit the assessment of tax motivated interest. Petitioners' suit is comfortably characterized as an action for a

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[3] Former Section 6621(c) originally was enacted as Section 6621(d). It was redesignated Section 6621(c) by the Tax Reform Act of 1986, Pub. L. No. 99-514, § 1511(a), 100 Stat. 2744.

refund "attributable to partnership items" (26 U.S.C. 7422(h)). The interest became due because the IRS determined that the partnerships' transactions were sham transactions and that the resulting underpayments of tax therefore were attributable to "tax motivated" transactions (26 U.S.C. 6621(c)(3)(A) (1988)). To show that the assessment of such interest against them was improper, petitioners would need to refute the determinations, made at the partnership level in the FPAAs, that the transactions underlying their disallowed partnership deductions were shams.[4]

Section 7422(h) bars any such challenge in a refund action.[5] As the court of appeals explained (Pet. App. 13-14), the nature of a partnership's transactions—including the question whether they are tax motivated transactions for purposes of former Section 6621(c)—is

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[4] FPAA determinations support the assessment of tax and interest against partners, unless those determinations are subsequently readjusted by the Tax Court or altered by the terms of a settlement. See 26 U.S.C. 6225(a), 6226(a) and (f), 6229(d), 6231(b)(1)(C). The Tax Court did not readjust the FPAA sham-transaction determinations (and, in fact, later upheld them), and the settlements did not alter those determinations. Pet. App. 4.

[5] The courts below viewed Section 7422(h) as a limitation on the subject-matter jurisdiction of the Court of Federal Claims, and petitioners do not dispute that characterization. Although Section 7422(h) does not use the term "jurisdiction," it implicates principles of sovereign immunity, cf. *United States* v. *Dalm*, 494 U.S. 596, 608-609 (1990), and it is properly read in conjunction with 26 U.S.C. 6226(f), which defines the scope of judicial review in partnership-level proceedings and does use the term "jurisdiction." In any event, because the government timely invoked Section 7422(h) as a ground for dismissal of petitioners' claims, the correct disposition of this case does not turn on whether Section 7422(h) is properly viewed as jurisdictional. Cf. *Kontrick* v. *Ryan*, 540 U.S. 443, 456 (2004) (noting that even non-jurisdictional rules may be "unalterable on a party's application").

a partnership item. See *Nault* v. *United States*, 517 F.3d 2, 8 (1st Cir. 2008); *RJT Invs. X* v. *Commissioner*, 491 F.3d 732, 737-738 (8th Cir. 2007); *River City Ranches #1 Ltd.* v. *Commissioner*, 401 F.3d 1136, 1144 (9th Cir. 2005); *Randell* v. *United States*, 64 F.3d 101, 107-108 (2d Cir. 1995), cert. denied, 519 U.S. 815 (1996). The nature of partnership transactions "underlie[s] the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc." of the partnership, within the meaning of 26 C.F.R. 301.6231(a)(3)-1(b). And the nature of partnership transactions "is more appropriately determined at the partnership level," 26 U.S.C. 6231(a)(3), because it affects the tax liability of all of the partners.

That tax motivated interest is not itself a partnership item (Pet. 10, 14-15) is beside the point. The dispositive question—as the statute expressly provides—is whether the interest at issue is "*attributable to* partnership items." 26 U.S.C. 7422(h) (emphasis added). Under petitioners' interpretation of Section 7422(h), the provision would have virtually no application because tax, interest, and penalties—the only items for which any taxpayer can ever claim a refund—are not themselves partnership items.

Petitioners assert (Pet. 16) that the court of appeals' decision "denies [partners] any forum" to challenge the assessment of tax motivated interest. That is incorrect. In the very partnership proceedings in which petitioners were parties, the partners challenged the IRS determination in the FPAAs that the partnerships' transactions were shams. Pet. App. 3. Petitioners had notice of that issue, but they chose to settle their cases with the IRS and receive benefits under their settlement agreements (which allowed a portion of the deductions that the IRS

originally had disallowed in full). *Id.* at 4, 49-50. The Tax Court ultimately decided the sham-transaction issue against the partners. *Id.* at 4 n.2. Section 7422(h) precludes petitioners' current effort to relitigate the issue in a refund action. Rather, TEFRA requires partners who intend to contest partnership-level issues to do so in the partnership-level proceeding. See pp. 2-3, *supra*.

c. Petitioners assert (Pet. 12-15) that the Court's intervention is necessary to resolve a purported conflict among the courts of appeals. That argument lacks merit. All the decisions cited by petitioners are readily distinguishable from the Federal Circuit's decision in this case.

Petitioners contend (Pet. 12) that the court of appeals' ruling conflicts with the Fifth Circuit's decision in *Weiner* v. *United States*, 389 F.3d 152 (2004), cert. denied, 544 U.S. 1050 (2005). As petitioners concede (Pet. 7), however, the Fifth Circuit in *Weiner* did not address the applicability of 26 U.S.C. 7422(h) to former Section 6621(c). Petitioners rely (Pet. 7, 11-13, 18-20) on *Weiner* to argue, on the merits, that tax motivated interest was improperly imposed against them because the FPAAs listed multiple grounds, which petitioners allege were "separable," for disallowance of the partnerships' deductions. See *Weiner*, 389 F.3d at 159-163. The Federal Circuit, while observing that it "would not be persuaded" by that argument in any event, held as a threshold matter that the Court of Federal Claims lacked jurisdiction to consider it. Pet. App. 16. Nothing in *Weiner* is inconsistent with that holding.

Petitioners also contend that the decision in this case conflicts with the Second Circuit's decision in *Field* v. *United States*, 328 F.3d 58 (2003). Although the court in *Field* held that the district court could consider the

claim for refund of tax motivated interest in that case, the case did *not* address petitioners' particular claim, *i.e.*, whether the court could make a partner-level determination regarding the nature of partnership transactions. Rather, the taxpayers' refund claim in *Field* presented the distinct question whether tax motivated interest constituted "interest" under 26 U.S.C. 6601 or was instead a penalty (as relevant for statute-of-limitations purposes). See *Field* v. *United States*, 381 F.3d 109, 111 (2d Cir. 2004).

The Ninth Circuit's decision in *Keller* v. *Commissioner*, 568 F.3d 710 (2009), is also distinguishable. *Keller* was a collection due process case, not a refund suit, and thus did not implicate Section 7422(h) at all. Further, the court in the partnership proceeding in *Keller* had erroneously concluded that it lacked jurisdiction to determine whether the partnerships' transactions were tax motivated. *Id.* at 715. The Ninth Circuit held, under the unique circumstances of that case, that the Tax Court (which possessed jurisdiction under 26 U.S.C. 6330(c)(2)(B) to consider the taxpayers' liability if the taxpayers had received no prior opportunity to dispute it) could examine the partnership-level decision and evidence as to whether the partnership transactions were tax motivated. *Keller*, 568 U.S. at 723. The Ninth Circuit emphasized, however, that "[i]n exercising this jurisdiction the Tax Court should not be making an independent judgment at the partner level about whether partnership transactions were tax motivated." *Ibid.* The Court explained, as it had held in *River City Ranches #1 Ltd.*, that the character of partnership

transactions is a partnership item to be determined at the partnership level. *Id.* at 722.[6]

d. In any event, as noted above (p. 8, *supra*), former Section 6621(c) was repealed in 1989. See OBRA, § 7721(b), 103 Stat. 2399. The only transactions to which that repealed interest provision could apply were reported on tax returns due to be filed on or before December 31, 1989. See § 7721(d), 103 Stat. 2400. The statute does not apply to any new transactions. Although petitioners' counsel has filed "many AMCOR related refund suits" (Pet. 20), and claims to "represent many more partners with similar refund claims" (*ibid.*), the universe of taxpayers potentially affected by former Section 6621(c) is necessarily finite and diminishing. Petitioners' conjecture that "likely there are thousands more § 6621(c) claims" (Pet. 21) strains credulity, as the statute was repealed 20 years ago.[7] The issue raised in the petition therefore is one of limited and declining importance.

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[6] Petitioners also suggest (Pet. 15) that the decision below conflicts with the Federal Circuit's prior decision in *Prochorenko* v. *United States*, 243 F.3d 1359 (2001). But unlike *Prochorenko*, which involved an issue "entirely dependent on [the partner's] own unique factual circumstances" (*id.* at 1363), this case involves issues that affect all partners and are not dependent on facts unique to a particular partner (Pet. App. 14). In any event, any intra-circuit conflict would not warrant this Court's review. See *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957) (per curiam).

[7] Petitioners note (Pet. 21) that cases arising out of the Hoyt tax-shelter partnerships also involved former Section 6621(c). The Ninth Circuit's decisions, however, have largely resolved those issues. See *Keller*, 568 F.3d at 710; *River City Ranches* v. *Commissioner*, 313 Fed. Appx. 935, 938 (9th Cir. 2009); *River City Ranches #1 Ltd.*, 401 F.3d at 1136.

2. Petitioners also contend (Pet. 25-33) that the Court of Federal Claims should have entertained their limitations defense to the assessments in a partner-level refund suit. The court of appeals correctly rejected that argument, and its holding is consistent with the decisions of all other court of appeals that have considered the question. The issue therefore does not warrant this Court's review.

a. After the completion of partnership proceedings, any income tax attributable to partnership items is assessed at the partner level. See 26 U.S.C. 701. The IRS has the greater of the three-year period in 26 U.S.C. 6501 (which is based on the partner's individual return) or the three-year period in 26 U.S.C. 6229(a) (which is based on the partnership return) to make an assessment attributable to a partnership item. See *AD Global Fund, LLC* v. *United States*, 481 F.3d 1351, 1354 (Fed. Cir. 2007). The issuance of an FPAA suspends the statute of limitations during the time that a petition for readjustment of partnership items may be filed, and for one year thereafter. 26 U.S.C. 6229(d).

b. The court of appeals correctly held that petitioners' refund claim that the assessments were made after the limitations period had expired is a partnership item and is therefore barred by Section 7422(h). Petitioners' limitations claim "is more appropriately determined at the partnership level," 26 U.S.C. 6231(a)(3), because it requires a construction of 26 U.S.C. 6229 and therefore affects the tax liability of all of the partners.[8] The limi-

[8] For example, adjudicating petitioners' limitations claim would require determinations as to whether the FPAAs were issued in time to suspend the limitations period, 26 U.S.C. 6229(d), and whether the "tax matters" partner had agreed to extend the limitations period, 26 U.S.C. 6229(b)(1)(B).

tations issue also "underlie[s] the determination of the amount, timing, and characterization of items of income, credit, gain, loss, deduction, etc." of the partnership, within the meaning of 26 C.F.R. 301.6231(a)(3)-1(b). As the court of appeals noted, petitioners "do not dispute that this regulation includes their limitations claim in its definition of 'partnership items.'" Pet. App. 8.

Contrary to petitioners' contention (Pet. 30-31), the court of appeals properly deferred to the agency's interpretation of the term "partnership item." That regulation was adopted pursuant to the congressional directive contained in 26 U.S.C. 6231(a)(3). When Congress authorizes an agency to promulgate rules addressing a specific area of concern, regulations adopted under that authority "are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Chevron*, 467 U.S. at 843-844.

Petitioners argue (Pet. 26) that under the court of appeals' decision, partners "have *no* court of competent jurisdiction in which to raise their limitations defense" for pre-1997 taxable years. That is incorrect. The limitations defense was raised in the very partnership proceedings in which petitioners were parties, Pet. App. 3, but petitioners chose to settle their cases, *id.* at 4. Petitioners' related contention (Pet. 25) that they were "barred by statute" from pursuing their limitations defense in the partnership proceedings is similarly incorrect. See, *e.g.*, *Rhone-Poulenc Surfactants & Specialties, L.P.* v. *Commissioner*, 114 T.C. 533, 535 (2000); C-99 Ltd. v. *Commissioner*, 66 T.C.M. (CCH) 1485, 1486-1488 (1993); *Genesis Oil & Gas, Ltd.* v. *Commissioner*, 93 T.C. 562, 564 (1989). In any event, as petitioners acknowledge (Pet. 25 n.26), a 1997 amendment expressly permits partners to participate in partnership

proceedings solely for the purpose of asserting that the limitations period had expired. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1239(b), 111 Stat. 1027 (adding concluding clause to 26 U.S.C. 6226(d)(1)). Even if petitioners could demonstrate that the former statutory scheme raised significant due process concerns, their constitutional claims are thus of little prospective importance.

c. In any event, petitioners do not allege a conflict between the court of appeals' disposition of the limitations issue and any decision of another court of appeals. To the contrary, the Federal Circuit's decision is in agreement with that of every other court of appeals to have considered the question. Four other courts of appeals have held that the limitations defense that petitioners sought to raise here is a partnership item that cannot be raised in a partner-level proceeding. See *Weiner*, 389 F.3d at 159; *Davenport Recycling Assocs.* v. *Commissioner*, 220 F.3d 1255, 1260 (11th Cir. 2000); *Chimblo* v. *Commissioner*, 177 F.3d 119, 125 (2d Cir. 1999), cert. denied, 528 U.S. 1154 (2000); *Kaplan* v. *United States*, 133 F.3d 469, 474 (7th Cir. 1998). Absent a conflict among the courts of appeals, this Court's review is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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AUGUST 2009

(3)

Supreme Court, U.S.
FILED
SEP 17 2009
OFFICE OF THE CLERK

No. 08-1546

In the

Supreme Court of the United States

KENNETH C. KEENER,
WILLIAM P. SMITH, and ANNE D. SMITH,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

ON A PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

REPLY TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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1. Status of Related Litigation

After the petition for writ of *certiorari* was filed in this matter, the Federal Circuit denied the Government's motion for summary affirmance in related cases based on *Keener*[1] and selected two of those appeals as representative cases for briefing regarding issues similar to those here and other unrelated issues – *Prati v. U.S.* (Fed.Cir. #2008-5117) and *Deegan v. U.S.* (Fed.Cir. #2008-5129). Appellants' opening briefs have been filed in both cases. Appellee's brief are pending.

2. Section 6621(c) Penalty Interest

In contrast to the Government's reliance on a "Blue Book" assertion that §6621(c) was enacted to discourage the proliferation of abusive tax shelters, direct legislative history specifically states §6621(c) and other accuracy-related penalties (*e.g.* §6659 valuation overstatement) were enacted as tools to encourage settlement in order to manage the Tax Court's docket. Congress pointedly reminded the IRS that its settlement policy should be fair and flexible and only appropriate cases should be litigated.[2] The IRS's own litigation guidelines consistently advise that the specter of §6621(c) should be used to encourage settlement.[3] In *Law*, an early §6621(c) case, Tax Court Judge Whitaker recognized the "*in terrorem*" intent to encourage settlement would not be served by allowing the government to impose

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1 *Keener v. U.S.*, 551 F.3d 1358 (Fed.Cir. 2009).

2 See *Todd v. C.I.R.*, 862 F.2d 540, 544 and n.14 (5th Cir.1988) and *Todd v. C.I.R.*, 89 T.C. 912, 916-18 (1987), *citing* H.R.Conf.Rep. No. 861, 98th Cong., 2d Sess. 984-5 (1984).

3 1998 LGM TL-21, 1998 WL 1758202 (September 4, 1998); 1989 LGM TL-21, 1989 WL 989830 (August 7, 1989); 1990 LGM TL-21, 1990 WL 1086208 (February 2, 1990); 1988 LGM TL-21, 1988 WL 898187 (January 22, 1988). Cited as persuasive authority only.

§6621(c) after conclusion of a controversy.[4]

Treas.Reg. 301.6621-2T, A-5 is consistent with intent to encourage settlement and reduce litigation. Settlement obviates the need for trial on the merits of each ground for adjustment proposed by the IRS.[5] And where, as here, a settlement does not identify grounds for the adjustment, the determination of whether a liability is "attributable to" a TMT is made using all grounds originally proposed by the IRS.[6] Treas.Reg. §301.6621-2T, A-5 mandates that tax liability attributable to non-TMT grounds for adjustment are taken into account before TMT grounds when considering whether an underpayment is "attributable to" a TMT. Congress prefaced the virtually identical §6659 formula with instructions that: *"[t]he portion of a tax underpayment that is attributable to a valuation overstatement will be determined after taking into account any other proper adjustments to tax liability."*[7]

At least two consequences follow from the mandate to

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4 *Law v. C.I.R.*, 84 T.C. 985, 994-5 (1985).

5 In *Law*, the court noted that even after trial on the merits of each ground for adjustment there could still be multiple equally-valid grounds for an adjustment, some TMT and some not. 84 T.C. at 993-4.

6 *Weiner v. U.S.*, 389 F.3d 152-53 (5th Cir.2004); *Heasley v. C.I.R.*, 902 F.2d 380, 382 (5th Cir. 1990). The Government agrees that in the absence of a redetermination in the settlement, all grounds for adjustment originally asserted in the FPAA most be considered in making the §6621(c) determination. U.S.Opp. at n.4.

7 *Todd*, 862 F.2d at 542. [Emphasis in original.] Because both §6621(c) and §6659 require an "attributable to" determination and use an almost identical formula to make that determination, analysis and precedent for both provisions is used interchangeably. See *Heasley*, 902 F.2d at n.5; *McCrary v. C.I.R.*, 92 T.C. 827, 857-860 (1989); *Sinclair v. C.I.R.*, 58 T.C.M. (CCH) 1140, 1142 (1990).

take non-TMT grounds into account first: (i) it is improper to preferentially cherry-pick TMTs and exclude non-TMT grounds; and (ii) only underpayments that are *solely* attributable to TMTs are subject to §6621(c).[8] If the IRS shotguns the original grounds for adjustment, there is no basis to impose §6621(c) unless a settlement specifically attributes an adjustment to a TMT or agrees to §6621(c). These settlements did neither.

Contrary to the Government's assertion, it is not necessary for petitioners to refute any ground for adjustment in the FPAAs, sham or otherwise, to prove that §6621(c) interest was improperly assessed. The plain language of Petitioners' claims assert the IRS assessed §6621(c) in violation of Treas.Reg. §301.6621-2T, A-5. Pet.App.190 and 195 at ¶5. In the FPAAs the IRS proposed 10-20 grounds for completely disallowing the partnerships' farming expenses and other deductions, some TMTs and some not. Pet.App.220-225 and App:226-230. Petitioners settlements allowed over half of the farming expense deductions but did not identify the grounds for adjusting the portion that was disallowed. Application of Treas.Reg. §301.6621-2T, A-5 to these facts establishes that no portion of the resulting underpayment was "attributable to" a TMT.

Keener ignored Treas.Reg. §301.6621-2T, A-5. The *Keener* jurisdictional determination also improperly cherry-picked sham from among 10-20 alternative, equally-valid, mostly non-TMT grounds for adjustment. The Government likewise ignores the controlling regulation in its opposition brief and also cherry-picks sham.

Moreover, the Government's "jurisdictional" argument is actually an assertion that sham was the sole ground for adjustment, a defense to the merits of the claim. *Keener* and

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[8] See *Weiner*, 389 F.3d at 152-3 and authorities cited therein, including *Todd* and *Irom v. C.I.R.*, 866 F.2d 545 (2d Cir. 1989).

the Government conflate the merits of whether the regulation *was violated* with the jurisdictional question of whether the court *may consider* whether the regulation was violated.[9] This approach improperly reverses the proper sequence of determining jurisdiction before reaching the merits.[10]

Weiner illustrates this conflation of jurisdiction and merits and disproves the Government's assertion that nothing in *Weiner* is contrary to *Keener*. In *Weiner* the Government presented its sham argument for what it is, a defense to the merits of the claim, not a §7422(h) challenge. The trial court denied the plaintiff's motion for summary judgment based on Treas.Reg. §301.6621-2T and set the Government's sham defense for trial on the merits. [11] On appeal the Fifth Circuit did not reach the sham defense, finding that issue was moot because application of Treas.Reg. §301.6621-2T, A-5 proved no portion of the underpayment was attributable to a TMT, sham or otherwise.

Weiner expressly recognized that several of the many grounds for adjustment in the FPAAs were separable, independent non-TMTs, particularly "not trade or business" and "not ordinary and necessary under §162."[12] In *Keener*, the Federal Circuit intimated, without analysis or authority, that the grounds for adjustment in the FPAAs

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9 *FFTF Restoration Co., LLC v. U.S.*, 86 Fed.Cl. 226, 243-4 (Fed.Cl. 2009).

10 *Alliant Techsystems, Inc. v. U.S.*, 178 F.3 1260, 1265 (Fed.Cir. 1999).

11 *Weiner v. U.S.*, 255 F.Supp.2d 673, 676 (S.D.Tex. 2002).

12 *Weiner*, 389 F.3d at n.10.

were inseparable.[13] But most of the grounds for adjustment in *Weiner* are identical to those in *Keener*, including "not trade or business" and "not ordinary and necessary under §162." Pet.App:220, 226, 231, 236, 242, 250-1 at ¶5 and 6, and 248 at ¶ 2 and 3. The Government has not responded to this conflict between the Fifth and Federal Circuits.

The jurisdictional issue before the Court is whether petitioners' claims for refund of §6621(c) interest are claims for a "refund attributable to partnership items (as described in §6231(a)(3))." Petitioners do not disagree that the determination of partnership items can only be made in partnership-level proceedings. But petitioners do not seek determinations regarding any of the grounds for adjustment in the FPAAs or the nature of partnership items. When Treas.Reg. §301.6221-2T, A-5 is properly considered it becomes clear that petitioners' claims are not attributable to partnership items and not barred by §7422(h). They are claims for refund attributable to the IRS's failure to apply the formula at Treas.Reg. §301.6621-2T, A-5 as required before imposing §6621(c) rate of interest.

The Court of Federal Claims and the federal district courts have jurisdiction over §6621(c) claims. The Government does not refute that §6621(c) interest is not a §6231(a)(3) partnership item but is a §6231(a)(5) affected item and/or a §6231(a)(4) non-partnership item. In *Field*, the Second Circuit held §6621(c) is not a partnership item and not barred by §7422(h).[14] The Government attempts to distinguish *Field*, asserting the issue was whether §6621(c) is interest or a penalty. But the Government's authority

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13 *Keener*, 551 F.3d at 1367.

14 *Field v. U.S.*, 328 F.3d 58 (2nd Cir. 2003).

rests on a subsequent appellate decision.[15] The earlier decision reported at 328 F.3d 58 speaks for itself.

The *Keener* approach to §7422(h) urged by the Government here is over-broad and encompasses all affected items not just §6621(c) claims. There is no precedent for holding that *§6621(c)* is a partnership item, that *§6621(c)* should be determined at the partnership level, that all TMTs are partnership items, and/or that all components of TMTs *must* be determined at the partnership-level. There is certainly no authority for the proposition that review of IRS's actions based on the binding partnership items as determined is somehow itself "attributable to a partnership item."

In *Keller*, the Ninth Circuit specifically referred to its *River City*[16] holding in narrow terms: "the Tax Court-at the level of partnership proceedings-had jurisdiction to rule on the character of the partnerships' transactions for purposes of §6621(c) interest."[17] *Keller* also recognized the difference between jurisdiction to make partnership-level findings (as in *River City*) and jurisdiction over partner-level claims that the IRS improperly imposed §6621(c) after the partnership-level proceedings concluded without establishing a basis to impose §6621(c) (as here). In the latter instance, the partnership-item grounds for adjustment are not at issue, the Tax Court lacks jurisdiction over the §6621(c) claim, and the partner-level §6621(c) refund claims does not violate the §7422(h) prohibition. The Government has not addressed this distinction between the two types of claims.

While *Keener's* broad application of §7422(h) conflicts

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15 *Field v. U.S.*, 381 F.3d 109 (2nd Cir. 2004).

16 *River City Ranches # 1 Ltd. v. C.I.R.*, 401 F.3d 1136 (9th Cir. 2005).

17 *Keller v. U.S.*, 568 F.3d 710, 722 (9th Cir. 2009). Pet.App.83-4.

intra-circuit with *Prochorenko*,[18] that decision also conflicts with the Second Circuit's decisions in *Field* and *Monti* that §7422(h) should be narrowly read and applies only to claims for refund that are directly attributable to partnership items and not to claims that merely flow from partnership items.[19] The Government did not respond to this split in the Circuits.

Also, *Keener* leaves taxpayer-partners with no recourse if §6621(c) is improperly imposed after conclusion of the partnership-level proceeding and in conflict with the results of these proceedings. The Government's assertion that partners can and should address §6621(c) at the partnership-level is based on its refusal to address the true nature of petitioners' §6621(c) claims – the IRS assessed §6621(c) in violation of Treas.Reg. §301.6621-2T,A-5 after the partnership-level proceedings had concluded with respect to the settling partners. Those partners were no longer parties to the partnership-level proceeding and had no forum other than a partner-level action to challenge the improper post-settlement imposition of §6621(c). *Keller* recognized the partners' dilemma in such situations and held the partner-level court may and should address the improper imposition of §6621(c), otherwise taxpayers are left with no possible review.

While §6621(c) claims may be headed for extinction, *Keener* applies to any erroneous assessment attributable to an affected item where the assessment is not supported by settlement or decision. That jurisdictional determination, which ignores the §6621(c) formula, applies to §6659 overvaluation penalty claims, which is now one of the §6662 penalties currently imposed by the IRS. Moreover, the

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18 *Prochorenko v. U.S.*, 243 F.3d 1359 (Fed.Cir. 2001).

19 *Monti v. U.S.*, 223 F.3d 76 (2d Cir. 2000).

meaning of "attributable to a partnership item" under §7422(h) remains a critical issue in all TEFRA partnership proceedings and cases, even if §6621(c) is of little importance.

3. Limitations

The Government misapplies *AD Global* and fails to address the Fifth Circuit's August 11, 2009 *Curr-Spec* opinion creating another inter-circuit split on the limitations issue presented here.[20] U.S.Opp.14; Supp.App.1,9.

When the Petitioners filed their claims it was unsettled whether the limitations period for assessments attributable to partnership items was controlled by §6501(a), §6229(a), or both,[21] so they separately asserted:

(1) "[t]he assessment ... was made after ... limitations ... expired," [§6501(a)] and

(2) "[t]he assessment ... was made more than three years after the Partnership return was filed." [§6229(a)]

Pet.App.188,193,198,204.

In *AD Global* the Federal Circuit has now held that "§6229(a) does not create an independent statute of limitations," thereby extinguishing the Petitioners' §6229(a) claims but strengthening their §6501(a) claims by establishing §6501 as the only limitations period for assessing "tax imposed for partnership items." Supp.App.5-6,7. Under *AD Global*, §6229(a) merely provides a possible

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[20] *AD Global Fund, LLC v. U.S.*, 481 F.3d 1351 (Fed.Cir.2007); *Curr-Spec Partners v. C.I.R.*, — F.3d —, 2009 WL 2437764 (5th Cir. August 11, 2009).

[21] IRS Field Service Advisory (April 6, 1994) 1994 WL 1865975.

extension of §6501(a)'s assessment period and, therefore, can be raised only by the Government as an exception to a partner's §6501(a) assessment deadline.

It is undisputed that the Petitioners timely filed their 1984 and 1985 returns and, unless an exception applies, §6501(a)'s 3-year deadline expired before assessment. Therefore, they established their *prima facie* §6501(a) case.[22] The burden then shifted to the Government to prove any §6229 exception and the court's jurisdiction to consider that exception.[23]

The Petitioners' refunds are attributable to their §6501(a) assessment deadline, a §6231(a)(4) *non*-partnership item. If, *arguendo*, §6229(a) is a partnership item, §6501(a) is, at most, a §6231(a)(5) affected item and §7422(h) cannot bar jurisdiction because §6501(a) is not a §6231(a)(3) partnership item. *Keener* erroneously imposed its pre-*AD Global* §6229(a) jurisdictional analysis on the Petitioners' §6501(a) claims.

On August 11, 2009, the Fifth Circuit adopted the

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[22] *Hoffman v. C.I.R.*, 119 T.C. 140, 146 (2002); citing *Reis v. C.I.R.*, 142 F.2d 900 (6th Cir. 1944), aff'g 1 T.C. 9, 12 (1942); *Mecom v. C.I.R.*, 101 T.C. 374, 382 (1993), aff'd w/o publ. op. 40 F.3d 385 (5th Cir. 1994); *J.H. Rutter Rex Mfg. v. C.I.R.*, 853 F.2d 1275, 1281 (5th Cir. 1988).

[23] *Payne v. C.I.R.*, 224 F.3d 415, 420 (5thCir. 2000) ("when the government relies on an exception to [§6501(a)], it bears the burden of proving its entitlement to rely on that exception."); *Adler v. C.I.R.*, 85 T.C. 535, 540-41 (1985); *Amesbury Apartments v. C.I.R.*, 95 T.C. 227 (1990); *Armes v. C.I.R.*, 448 F.2d 972,974 (5th Cir. 1971); *Concrete Engineering v. C.I.R.*, 58 F.2d 566 (8th Cir. 1932), aff'g 19 B.T.A. 212 (1930); *Feldman v. C.I.R.*, 20 F.3d 1128, 1132 (11th Cir. 1994); *Blueport Co. v. U.S.*, 533 F.3d 1374, 1381 (Fed.Cir. 2008) (This shift is in keeping with "the long-established practice of placing the burden of establishing jurisdiction on the party 'who claims that the power of the court should be exerted in his behalf.'") quoting *McNutt v. G.M.A.C.*, 298 U.S. 178, 189 (1936).

Federal Circuit's *AD Global* analysis,[24] correctly recognizing

> (1) "The practical result of our holding today is that the Commissioner may issue an FPAA at *anytime*, subject only to the practical limitation that the FPAA may affect only those partners whose individual returns remain open under IRC §6501(a) or some extension thereto, such as the *minimum* period of IRC §6229(a), before which the statute of limitations may not expire," and
>
> (2) while its holding will "permit assessments against some partners and not against others, depending on their respective limitations periods under IRC §6501(a), this interpretation is consistent with the other portions of IRC §6229, which explicitly contemplate distinct treatment of different partners. If Congress intended a different result, it is for Congress — not this court — to re-draft the statutory language."

Supp.App.22, footnotes omitted.

The Fifth Circuit also

> [E]mphasize[d], however, that once a partner's individual [§6501(a)] limitations [period] for any given tax year has run without that period having been extended ... the Commissioner has no authority to assess tax based on any partnership items against that partner ..., even if the Commissioner subsequently issues an FPAA for that year. The plain language of IRC §6501(a) guarantees as much.

Supp.App.21, footnotes omitted.

AD Global does not support the Government's position but instead evidences the intra-circuit split between

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[24] Supp.App.10,17,19-20.

AD Global (as a matter of law §6501(a) is the only applicable limitations period with §6229(a) merely providing a possible extension) and *Keener* (the Petitioners' claims are based solely on §6229(a)'s "statute of limitations"). Pet.App.7. And there is now an inter-circuit split between the Fifth Circuit (*Curr-Spec*) and the Federal Circuit (*Keener*) on the same issue.[25]

Finally, the Government states that "petitioners agreed to waive the restrictions on the assessment and collection of any deficiency attributable to partnership items." U.S.Opp.4. The Government knew or should have known that this statement is false. Section 6501(a) controls assessments attributable to partnership items. The Forms 870-P(AD) had no §6501(a) waiver. Supp.App.27-39. The Petitioners settled their partnership items "[i]n order to end their involvement in" the partnership-level Tax Court suits. Pet.App.3-4. Sections 6229(f) and 6231(b)(1)(C) require assessment within one year of settlement, but §6225(a)(2) bars assessment until after partnership-level suits are final. To avoid this Catch-22 Forms 870-P(AD)s have a boilerplate waiver of "the restrictions ... provided in section 6225(a)." Supp.App.27,30,34,37. A §6225(a) waiver cannot waive a partner's §6501(a) limitations deadline. If the Government intended such a waiver it should have included it in the Forms 870-P(AD).

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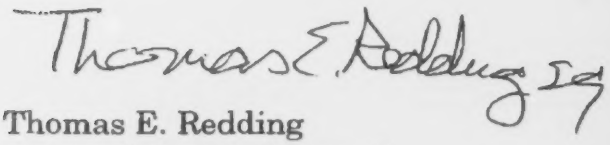
[25] *Curr-Spec* addressed tax year 1999 expressly relying on the 1997 §6226(d) and (f) amendments to determine those partners could have raised their §6501(a) claims in partnership-level Tax Court cases. Supp.App.15. But Congress expressly restricted those amendments to post 1996 tax years. The Petitioners' 1984 and 1985 §6501(a) claims have no such "express blessing," only an express bar. Pet.App.168.

Respectfully submitted.



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SEPTEMBER 2009

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United States Court of Appeals
for the Federal Circuit

06-5046

AD GLOBAL FUND, LLC,
by and through NORTH HILLS HOLDING, INC.,
a Partner Other Than the Tax Matters Partner,

Plaintiff-Appellant,

v.

UNITED STATES,

Defendant-Appellee.

David D. Aughtry, Chamberlain, Hrdlicka, White, Williams & Martin, of Atlanta, Georgia, argued for plaintiff-appellant. With him on the brief was Juan F. Vasquez, Jr. Of counsel was Kevin D. Jewell, of Houston, Texas.

Eileen J. O'Connor, Assistant Attorney General, Tax Division, United States Department of Justice, of Washington, DC, argued for defendant-appellee. With her on the brief were Richard T. Morrison, Deputy Assistant Attorney General, and Gilbert S. Rothenberg, Robert W. Metzler, and Michael J. Haungs, Attorneys.

M. Todd Welty, Meadows, Owens, Collier, Reed, Cousins & Blau, L.L.P., for amici curiae, J&J Fernandez Ventures, L.P., et al.

Appealed from: United States Court of Federal Claims

Judge Christine O.C. Miller

United States Court of Appeals
for the Federal Circuit

06-5046

AD GLOBAL FUND, LLC,
by and through NORTH HILLS HOLDINGS, INC.,
a Partner Other Than the Tax Matters Partner,

Plaintiff-Appellant,

v.

UNITED STATES,

Defendant-Appellee.

DECIDED: March 2, 2007

Before MAYER, PROST, Circuit Judges, and WHYTE, District Judge*.

WHYTE, District Judge.

This case concerns the interpretation of two sections of the Internal Revenue Code ("IRC"), I.R.C. §6229(a) and I.R.C. §6501. Appellant AD Global Fund, LLC ("AD Global") appeals from the judgment of the United States Court of Federal Claims. The Court of Federal Claims held that §6229(a) provides an extension of time to the statute of limitations in §6501 for assessing taxes on partnership items, not a separate statute of limitations for partnership items. AD Global Fund, LLC v. United States, 67 Fed. Cl. 657 (2005). Because we agree that §6229(a) does not provide a separate statute of limitations, but simply creates a minimum period that may extend the regular statute of

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* Honorable Ronald M. Whyte, District Judge, United States District Court for the Northern District of California, sitting by designation.

limitations for partnership items, we affirm.

I. BACKGROUND

AD Global is a limited liability company formed under the laws of the State of Delaware. North Hills Holding, Inc. ("North Hills") is a notice partner for AD Global. As a notice partner, North Hills filed the underlying civil action on behalf of AD Global and members of AD Global against the United States under I.R.C. §6226 challenging the validity of a Notice of Final Partnership Administrative Adjustment ("FPAA") issued by the Internal Revenue Service ("IRS").

AD Global is treated as a partnership for federal income tax purposes and is subject to the Uniform Partnership Procedures of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA"), I.R.C. §§6221-6234. The tax treatment of any partnership item[1] (and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item) is determined at the partnership level. I.R.C. §6221. The IRS may challenge the reporting of any partnership item on a partnership tax return (Form 1065) by issuing an FPAA, which serves as a predicate to its making individual partner tax assessments. I.R.C. §§6223(a)(2), 6225(a).

The FPAA at issue concerns AD Global's partnership tax year ending December 31, 1999. AD Global filed its 1999 partnership tax return on April 17, 2000. The IRS initiated administrative proceedings on May 27, 2003. On October 9, 2003, more than three years after AD Global had filed its 1999 return, the IRS issued an FPAA setting forth proposed adjustments and accuracy-related penalties to the partnership items reported in the return.

AD Global moved for summary judgment alleging that

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[1] Partnership items include "any item required to be taken into account for the partnership's taxable year." I.R.C. §6231(a)(3).

§6229(a) provides a separate statute of limitations for tax assessments on partnership items and that the FPAA was untimely under §6229(a). The Court of Federal Claims denied AD Global's motion for summary judgment, concluding that the regular statute of limitations in §6501(a) applies and that §6229(a) merely provides a minimum period for assessments for partnership items that may extend the time period set forth in §6501(a). If the conclusion of the Court of Federal Claims is correct, §6501(a) sets forth the assessment period for all assessments, including those attributable to partnership items, and allows assessments within 3 years after an individual partner files his or her return. AD Global does not claim that the FPAA was untimely if §6501(a) applies.

This appeal follows the order denying AD Global's motion for summary judgment which was certified for interlocutory appeal. We have jurisdiction pursuant to 28 U.S.C. §1292(c)(1).

II. DISCUSSION

This court reviews questions of statutory interpretation without deference. U.S. Steel Group v. United States, 225 F.3d 1284, 1286 (Fed. Cir. 2000). "As in all statutory construction cases, we begin with the language of the statute. The first step is to determine whether the language at issue has a plain and unambiguous meaning with regard to the particular dispute in the case." Barnhart v. Sigmon Coal Co., 534 U.S. 438, 450 (2002) (internal quotations and citations omitted). The inquiry ends "if the statutory language is unambiguous and the statutory scheme is coherent and consistent." Id. (internal quotations and citation omitted).

Section 6229(a) is entitled "Period of limitations for making assessments" and provides:

Except as otherwise provided in this section, the

> period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year shall not expire before the date which is 3 years after the later of--(1) the date on which the partnership return for such taxable year was filed, or (2) the last day for filing such return for such year (determined without regard to extensions).

Section 6501(a) provides in pertinent part: "Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed . . . ."

The Court of Federal Claims concluded that the language in §6229(a) is ambiguous because both AD Global and the United States' interpretations of the statutory language are plausible. It found the United States' interpretation plausible because §6229(a) does not explicitly state that it is an exception to the general statute of limitations in §6501 and uses the terminology "shall not expire before" rather than language traditionally associated with statutes of limitations. Nevertheless, the court found AD Global's interpretation plausible because §6229(a) is entitled "period of limitations" and §6229 refers to "periods of limitations" throughout.

Reading §6229(a) together with §6501, we conclude that §6229(a) unambiguously sets forth a minimum period for assessments of partnership items that may extend the regular statute of limitations in §6501. Section 6501 explicitly provides that it applies to any tax imposed by the title, which would include tax imposed for partnership items. See Andantech L.L.C. v. Comm'r, 331 F.3d 972, 976-77 (D.C. Cir. 2003) ("The plain language of §6501 compels its applications to all assessments."). No exception is

provided for assessment of taxes for partnership items.[2] Section 6501 simply cross-references §6229(a) as an "extension" of period for partnership items. See I.R.C. §6501(n)(2) ("For extension of period in the case of partnership items (as defined in section 6231(a)(3)), see section 6229."); Crnkovich v. United States, 202 F.3d 1325, 1335 n.7 (Fed. Cir. 2000). Moreover, the statute of limitations set forth in §6501 is couched in mandatory terms setting forth the maximum period within which tax assessments must be made: "shall be assessed within 3 years after the return was filed."

By contrast, the language in §6229(a) does not state a maximum period. Section 6229(a) employs the term "shall not expire before," which creates a minimum period during which the period for tax assessments for partnership items may not end. This minimum period may expire before or after the maximum period provided in §6501. Rhone-Poulenc Surfactants & Specialties, L.P. v. Comm'r, 114 T.C. 533, 542 (2000).

We are not persuaded by the trial court's conclusion that use of the phrase "period of limitations" renders the statute ambiguous as to whether it creates a separate statute of limitations. Where Congress "includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." Barnhart, 534 U.S. at 452. Unlike the unequivocal language creating a statute of limitations in §6501, §6229(a) contains no mandatory words establishing a time within which assessments must be made. As we

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[2] AD Global argues that the statute of limitations in §6501 cannot apply to partnership items because the period specified in §6501 is not incorporated into §6229(a). However, §6501(a) is the general statute of limitations. If §6229(a) were to operate as a separate statute of limitations, it would be the exception to the general rule in §6501.

noted in Crnkovich, 202 F.3d at 1335 n.7, the three-year limitations period in §6229(a) does not unambiguously define an end date for making an assessment because it uses the phrase "shall not expire before" and thus "leaves open the possibility that the applicable limitations period may expire after the periods set forth therein." Because §6229 does not state an end date or otherwise set forth a maximum period, it does not, on its face, create a statute of limitations.

Based on the plain text of the statute, §6229(a) does not create an independent statute of limitations. Because we conclude the statute is unambiguous as to this issue, we do not reach an analysis of the legislative history and legislative intent.

We also conclude that this interpretation is consistent with the overall statutory scheme. AD Global argues that Congress enacted TEFRA so that partnership items may be determined in a single proceeding at the partnership level rather than through "fragmented, duplicative, and potentially inconsistent separate proceedings for each partner." TEFRA generally requires determination of the tax treatment of partnership items at the partnership level. I.R.C. §6221. In the partnership-level administrative proceeding, the IRS may adjust items reported on the partnership tax return which, in turn, would affect the corresponding items on the income tax returns of the individual partners. See I.R.C. §6226(c); Crnkovich, 202 F.3d at 1328. Each partner receives notice of the beginning of such an administrative proceeding, may participate in the proceeding, and receives notice of the FPAA. See I.R.C. §§6223, 6224(a); Crnkovich, 202 F.3d at 1328.

This scheme contemplates that adjustments to partnership items are made in one proceeding before assessments are made at the individual partner level. Our interpretation may extend the regular statute of limitations

in §6501(a) for assessments to individual partners, but it does not alter the statutory scheme of determining partnership items in one partnership-level proceeding. Our construction, therefore, is consistent with a statutory scheme that intends that adjustments to a partnership tax return be completed in one consistent proceeding before individual partners are assessed for partnership items.

III. CONCLUSION

For the aforementioned reasons, we affirm.

AFFIRMED

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

FILED
August 11, 2009
Charles R. Fulbruge III
Clerk

No. 08-60815

CURR-SPEC PARTNERS, L.P.

Petitioner-Appellant

v.

COMMISSIONER OF INTERNAL REVENUE

Respondent-Appellee

Appeal from a Decision of
the United States Tax Court

Before REAVLEY, WIENER, SOUTHWICK, Circuit Judges.

JACQUES L. WIENER, Circuit Judge:

Petitioner-Appellant Curr-Spec Partners, L.P. ("Curr-Spec"), asks us to interpret the interplay between the limitation provisions of Internal Revenue Code ("IRC") §6229(a) and IRC §6501(a). Specifically, we are asked to determine whether IRC §6229(a) provides an independent limitations period for Respondent-Appellee Commissioner of Internal Revenue's (the "Commissioner's") issuance of a notice of Final Partnership Administrative Adjustment ("FPAA"). The Tax Court ruled in favor of the Commissioner, holding that IRC §6229(a) does not provide a separate statute of limitations for partnership items and

that the relevant limitations periods are those of each individual partner-generally three years *after the date of filing the individual's return*-as set forth in IRC §6501(a).[1] The Tax Court reasoned that the limitations period of IRC §6229(a) can prolong-but can never shorten-the period within which the Commissioner may assess individual tax liabilities attributable to partnership items. Although this issue of statutory interpretation is *res nova* in this circuit, the Tax Court sitting as an *en banc*-like court,[2] the D.C. Circuit,[3] and the Federal Circuit[4] have each resolved it in favor of the Commissioner. Affirming the Tax Court's decision, we now join these other courts and hold that IRC §6229(a) does not establish an independent statute of limitations for issuing FPAAs.

I. FACTS AND PROCEEDINGS

On October 11, 2000, the partnership, Curr-Spec, filed a Form 1065, U.S. Partnership Return of Income, for the

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1 Even though the statute of limitations runs three years after the date that the return was *filed*, *see* IRC §6501(a), a return filed early is generally deemed filed on the date that the return was due, thereby giving the Commissioner more than three years within which to assess tax. *See id.* §6501(b)(1).

2 *Rhone-Poulenc Surfactants & Specialties, L.P. v. Commissioner*, 114 T.C. 533, 2000 WL 863142 (2000) (en banc). Technically, the Tax Court does not sit *en banc*. Nevertheless, the full Tax Court reviews cases that the Chief Judge selects for review by the entire court. *See* IRC §7460; David F. Shores, *Deferential Review of Tax Court Decisions:* Dobson *Revisited*, 49 TAX LAW. 629, 646 n.117 (1996). *Rhone-Poulenc* is one such case, and, for simplicity, we will refer to it as decided *en banc*.

3 *Andantech L.L.C. v. Commissioner*, 331 F.3d 972 (D.C.Cir.2003).

4 *AD Global Fund, LLC ex rel. N. Hills Holding, Inc. v. United States*, 481 F.3d 1351 (Fed.Cir.2007).*Andantech L.L.C. v. Commissioner*, 331 F.3d 972 (D.C.Cir.2003).

taxable year 1999. More than four years later, on October 13, 2004, the Commissioner issued an FPAA determining that (1) the partnership was a sham, (2) as a result, all transactions in which it engaged would be treated as engaged in by the individual partners directly, (3) all income, deductions, gains, and losses reported by the partnership would be disallowed, and (4) the partners would be treated as having no basis in their respective partnership interests. Curr-Spec timely filed a petition in the Tax Court seeking review of the Commissioner's determination. Curr-Spec then filed motions (1) to dismiss for lack of jurisdiction and to strike, and (2) for summary judgment, contending, *inter alia,* that because the FPAA was issued more than three years after both the due date of the partnership's 1999 return and the date on which it was filed, the period of limitations for assessing tax attributable to partnership items had expired. Curr-Spec based its argument on its interpretation of IRC §6229(a) as an independent three-year statute of limitations (subject to specific extensions) for issuing an FPAA.

The Commissioner responded that at least three Curr-Spec partners had claimed net operating loss carryforwards of a 1999 partnership item on their respective individual 2000 and 2001 returns. The Commissioner proposed to assess tax based on the claimed carryforwards on these partners' 2000 and 2001 returns, under the theory that the FPAA was issued less than three years after the partners had filed their respective individual tax returns for those tax years, *viz.*, within the statute of limitations for individual returns as set forth in IRC §6501(a).

The Tax Court ruled in favor of the Commissioner, emphasizing that the Internal Revenue Code "prescribes no

period during which TEFRA [5] partnership-level proceedings, which begin with the mailing of an FPAA, must be commenced." The court held that IRC §6229(a) does not provide an assessment period independent of the three-year individual limitations period of IRC §6501(a); that instead IRC §6229(a) provides a three-year minimum, which can extend IRC §6501(a)'s period, but cannot curtail it.

This timely appeal followed, in which Curr-Spec challenges only the timeliness of the FPAA.[6]

II. ANALYSIS

A. Standard of Review

We review a Tax Court decision the same way that we would review a district court decision.[7] In the instant case, Curr-Spec presents purely an issue of statutory interpretation, which we review *de novo*.[8]

B. Statutory Framework

"[TEFRA] ... prescribes the administrative and litigation procedures for addressing partnership tax issues."[9] "[It] requires partnerships to file informational returns reflecting the distributive shares of income, gains, deductions, and credits attributable to its partners.

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5 "TEFRA" is the Tax Equity and Fiscal Responsibility Act of 1982.

6 In the instant proceedings, Curr-Spec has stipulated to the merits of the Commissioner's adjustments in the FPAA.

7 *Minton v. Commissioner*, 562 F.3d 730, 734 (5th Cir. 2009) (per curiam).

8 *Copeland v. Commissioner*, 290 F.3d 326, 329 (5th Cir.2002).

9 *United States v. Martinez* (*In re Martinez*), 564 F.3d 719, 726 (5th Cir.2009) (citing Pub.L. No. 97-248, §402(a), 96 Stat. 648, 653 (1982) (codified as amended at IRC §§6221-23)).

Accordingly, the individual partners are responsible for reporting their pro rata share of tax on their income tax returns."[10] Items more appropriate for determination at the partnership level are designated "partnership items," which are to be treated at the partnership level; other items are designated "nonpartnership items," which are to be treated at the individual partner level.[11]

When the IRS proposes an adjustment of taxes at the partnership level, it issues a notice of adjustment, the FPAA, which is analogous to the statutory notice of deficiency furnished to individuals.[12] After the FPAA becomes final, the Commissioner may assess tax to the individual partners whose tax returns for the year or years in question remain open under IRC §6501(a), for those partners' distributive shares of the adjusted partnership items.[13]

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10 *Weiner v. United States,* 389 F.3d 152, 154 (5th Cir.2004) (internal citation omitted); *see* IRC §6031 (partnership returns); *id.* §§701-04 (individual partners' reporting distributive shares of partnership income).

11 *In re Martinez,* 564 F.3d at 726; *see* IRC §6221 (mandating that partnership items be determined at the partnership level). A "partnership item" is statutorily defined as:

> any item required to be taken into account for the partnership's taxable year under any provision of subtitle A to the extent regulations prescribed by the Secretary provide that, for purposes of this subtitle, such item is more appropriately determined at the partnership level than at the partner level.

IRC §6231(a)(3); *see id.* §6231(a)(4) (defining "nonpartnership item").

12 *In re Martinez,* 564 F.3d at 726 (citing IRC §6223(a)).

13 *See* IRC §6225(a) (stating that the FPAA becomes final if it goes unchallenged for 150 days, or upon final judicial resolution of a petition for review of the FPAA). The IRS may sometimes assess this tax on individual partners, without notice, as a computational adjustment. *See*

IRC §6501(a) is the three-year statute of limitations which is generally applicable to the Commissioner's assessment of tax.[14] That section states:

> **General rule.**– Except as otherwise provided in this section, the amount of any tax imposed by this title *shall be assessed within 3 years* after the return was filed ..., and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period....[15]

IRC §6229(a), which Curr-Spec contends is a three-year statute of limitations for issuing an FPAA-and which, in the Commissioner's and the Tax Court's views, can only extend but not shorten the IRC §6501(a) period-states:

> **General rule.**– Except as otherwise provided in this section, the period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year *shall not expire before* the date which is 3 years after the later of-
>
> (1) the date on which the partnership return for such taxable year was filed, or

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Callaway v. Commissioner, 231 F.3d 106, 109-10 (2d Cir.2000) (citing IRC §§6225(a), 6230(a)(1), 6231(a)(6)). Other times, factual determinations of "affected items" at the partner level are necessary, which requires the issuance of a notice of deficiency. *See id.* at 110 (citing IRC §6230(a)(2)(A)(i)); *see also* IRC §6231(a)(5) (defining "affected item" as "any item to the extent such item is affected by a partnership item").

[14] *Payne v. Commissioner*, 224 F.3d 415, 419-20 (5th Cir.2000). This statute of limitations is subject to provisions in IRC §6501, IRC §6503, and elsewhere that toll the limitations period, *see Doe v. KPMG, LLP*, 398 F.3d 686, 688-89 (5th Cir.2005), none of which are at issue in the instant appeal.

[15] IRC §6501(a) (emphasis added).

> (2) the last day for filing such return for such year (determined without regard to extensions).[16]

C. IRC §6229(a) Does Not Establish an Independent Statute of Limitations for the Issuance of an FPAA

1. Jurisdiction

As an initial matter, Curr-Spec contends that in a partnership proceeding, courts have no jurisdiction to consider the filing date of a partner's individual return because that is not a partnership item but rather a nonpartnership item. [17] The scope of the Tax Court's jurisdiction in partnership proceedings, Curr-Spec argues, is limited to determination of "all partnership items of the partnership for the partnership taxable year to which the [FPAA] relates, the proper allocation of such items among partners, and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item."[18] Yet, Congress has made clear that any partner "shall be permitted to participate in [partnership-level litigation] solely for the purpose of asserting that the period of limitations for assessing any tax attributable to partnership items has expired *with respect to such person,* and the court having jurisdiction of such action shall have jurisdiction to consider such assertion."[19] Armed with Congress's express blessing, the Tax Court does not exceed its jurisdiction when it considers

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16 *Id.* §6229(a) (emphasis added).

17 As in the principal issue of statutory interpretation presented in Curr-Spec's appeal, our review of the Tax Court's jurisdiction is *de novo. Ferguson v. Commissioner,* 568 F.3d 498, 502 (5th Cir.2009).

18 IRC §6226(f).

19 *Id.* §6226(d)(1) (emphasis added).

the filing date of a partner's individual return.[20]

2. Merits

Curr-Spec asserts that even if the Tax Court is not jurisdictionally barred from referencing the filing date of a partner's individual return, a plain reading of IRC §6229 and IRC §6501 *in pari materia* yields Curr-Spec's desired result, *viz.*, that IRC §6229(a) is an independent three-year limitations period for the issuance of an FPAA, which period begins to run on the later of the date that the partnership files its informational return or the date that it is due. In Curr-Spec's view, the TEFRA partnership procedures establish a time line governing when an FPAA may be issued, which is entirely independent of and distinct from-and which supercedes-the general time line specified by IRC §6501. The Commissioner counters that IRC §6229(a), by its terms, sets no limitation period for the issuance of an FPAA. The Commissioner argues that-for partnership items-IRC §6229(a) works to extend the IRC §6501(a) limitations periods of the individual partners under circumstances when those periods would otherwise expire less than three years following the later of the filing date or due date for the filing of the partnership's return, disregarding extensions.

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[20] Our opinion in *Weiner v. United States* is not to the contrary. 389 F.3d 152 (5th Cir. 2004). We decided that case on the dissimilar issue "whether district courts have jurisdiction to decide the FPAA statute of limitations question in [individual] refund actions." *Id.* at 155. More specifically, we asked "whether the taxpayers' refund requests [were] attributable to any partnership item such that the district court would be deprived of jurisdiction." *Id.* We concluded that IRC §6229(a)'s period was a partnership item and that thus "the district courts lack jurisdiction to decide the FPAA statute of limitations issue" (which, today, we conclusively determine is not an independent "statute of limitations"). *See id.* at 156, 159. In *Weiner*, we had no occasion to inquire whether, in a partnership proceeding, the Tax Court was deprived of jurisdiction to consider the filing date of a partner's individual return.

"When the plain language of a statute is unambiguous and does not lead to an absurd result, our inquiry begins and ends with the plain meaning of that language."[21] The unambiguous language of IRC §6229(a) and IRC §6501(a) mandates our conclusion that IRC §6501(a) creates a three-year limitations period within which the Commissioner must assess "any tax" on individual partners-a period which IRC §6229(a) can never shorten, regardless of the length of time that might have elapsed between the filing of the partnership's informational return and the Commissioner's issuance of an FPAA. Rather, IRC §6229(a) establishes only the *minimum* time period that, when necessary, extends, i.e., supercedes, the general three-year limitations period of IRC §6501(a). For partnership items, the otherwise applicable limitations period of IRC §6501(a) " *shall not expire before* the date which is 3 years after the later of ... the date on which the partnership return ... was filed" or the date on which it was due.[22] In reaching this conclusion, we find persuasive (1) the Tax Court's *en banc* decision in *Rhone-Poulenc Surfactants & Specialties, L.P. v. Commissioner,*[23] (2) the D.C. Circuit's opinion in *Andantech L.L.C. v. Commissioner,*[24] and (3) the Federal Circuit's opinion in *AD Global Fund, LLC ex rel. North Hills Holding, Inc. v. United States.*[25]

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21 *United States v. Dison,* — F.3d —, 2009 WL 1759029, at *2 (5th Cir. 2009) (internal quotation marks and citation omitted).

22 IRC §6229(a) (emphasis added).

23 114 T.C. 533, 2000 WL 863142 (2000) (en banc).

24 331 F.3d 972 (D.C.Cir.2003).

25 481 F.3d 1351 (Fed.Cir.2007). The Ninth Circuit has also referred to IRC §6229(a) as a minimum period for assessment. *Bakersfield Energy Partners, LP v. Commissioner,* 568 F.3d 767, 770 n. 5 (9th Cir.2009) ("Subsection (a) [of IRC §6229] provides the minimum time period in

In *Rhone-Poulenc,* the Tax Court said:

> Section 6501 unequivocally provides the period of limitations within which "the amount of *any* tax imposed by this title shall be assessed." Generally, the period of limitations so provided is 3 years from the date the taxpayer's return was filed but varies in the case of certain enumerated exceptions. The pertinent language of section 6229 is: "*[T]he period for assessing any tax imposed by subtitle A* with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year *shall not expire before* the date which is 3 years after the later of" the filing or due date of the partnership return. Section 6229 provides a *minimum* period of time for the assessment of any tax attributable to partnership items (or affected items) notwithstanding the period provided for in section 6501, which is ordinarily the *maximum* period for the assessment of any tax. The section 6229 minimum period may expire before or after the section 6501 maximum period. Indeed, section 6501(n)(2) cross-references section 6229 by providing: "For *extension* of period in the case of partnership items (as defined in section 6231(a)(3)), see section 6229." [26]

In *Andantech,* the D.C. Circuit, quoted the foregoing *Rhone-Poulenc* language, and determined that nothing in the Tax Court's reasoning gave it pause.[27] That court thus concluded that IRC §6501(a)'s statute of limitations is

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which the IRS can assess a tax deficiency.").

[26] 114 T.C. at 542 (internal citations and footnotes omitted) (emphases added by Tax Court).

[27] 331 F.3d at 977.

applicable to all assessments made under the chapter and that IRC §6229(a) can only extend, not cut short, the IRC §6501(a) period for partnership items.[28] The *Andantech* court further stated that "the language of §6229, rather than simply stating a three-year statute of limitations, indicates by the use of the term 'shall not expire' that the provision is intended to dictate a minimum period, but not an absolute restriction."[29]

The Federal Circuit, in *AD Global Fund,* reached the same result as had the D.C. Circuit and the *en banc* Tax Court before it. The court in *AD Global Fund* emphasized that

> [IRC] §6229(a) unambiguously sets forth a minimum period for assessments of partnership items that may extend the regular statute of limitations in §6501. Section 6501 explicitly provides that it applies to any tax imposed by the title, which would include tax imposed for partnership items ..., [and] [n]o exception is provided for assessment of taxes for partnership items.[30]

> Additionally, that court found it significant that-unlike IRC §6229(a)-IRC " §6501 is couched in mandatory terms setting forth the maximum period within which tax assessments must be made: 'shall be assessed within three years after the return was filed.' "[31] In contrast, IRC " §6229(a) employs the term 'shall not expire before,' which creates a minimum period during which the period for tax

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28 *Id.*

29 *Id.*

30 481 F.3d at 1354 (internal citation omitted).

31 *Id.* (quoting IRC § 6501(a)).

assessments for partnership items may not end."[32] And, "[w]here Congress 'includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.' "[33] The Federal Circuit viewed the use of "shall not expire before" in IRC §6229(a) as significant. That court described its result as consistent with the TEFRA scheme, which generally requires determination of the tax treatment of partnership items at the partnership level before they are assessed at the partner level.[34] First, the Commissioner ascertains all partnership items in a consolidated partnership-level determination; then IRC §6501 controls, separately as to each individual partner, the tax consequences of that initial partnership-level determination.[35] IRC §6229(a) "may extend the regular statute of limitations in §6501(a) for assessments to individual partners, but it does not alter the statutory scheme of determining partnership items in one partnership-level proceeding."[36]

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32 *Id.; see Salman Ranch Ltd. v. United States,* — F.3d —, 2009 WL 2256020, at *3 (Fed.Cir.2009) (explaining that the general three-year period of IRC § 6501(a) applies to partnership items and that IRC §6229(a) sets only a *minimum* period for assessments of partnership items).

33 *AD Global Fund,* 481 F.3d at 1354 (quoting *Barnhart v. Sigmon Coal Co.*, 534 U.S. 438, 452, 122 S.Ct. 941, 151 L.Ed.2d 908 (2002)).

34 *Id.* at 1354-55.

35 *Id.* at 1355.

36 *Id.*

We perceive no flaw in the interpretations of those courts, which reached the instant issue before we did, and we adopt their analyses.[37] We emphasize, however, that once a partner's individual three-year statute of limitations under IRC §6501(a) for any given tax year has run without that period having been extended under IRC §6229 or any other statute,[38] the Commissioner has no authority to assess tax based on any partnership items against that partner for that closed tax year, even if the Commissioner subsequently issues an FPAA for that year. The plain language of IRC §6501(a) guarantees as much. As counsel for the Commissioner represented at oral argument, "[i]f one partner carried [partnership losses] over ten years, but the others did not and used it all in '99, the Commissioner wouldn't be able to assess against them.... It's only to the extent that a partner's individual statute of limitations is

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37 The unambiguous statutory language mandates our result today. Nevertheless, even if the correct decision were not so clear, we would look to the opinions of the D.C. and Federal Circuits for persuasive guidance. *See Alfaro v. Commissioner,* 349 F.3d 225, 229 (5th Cir.2003) ("We are always chary to create a circuit split.").

38 The limitations period may be extended for any of several reasons. As we have discussed, IRC §6229(a) provides for an extension when three years from the date the partnership return is filed or is due has not yet expired. The IRC §6229(a) period itself is suspended when the Commissioner files an FPAA. *See* IRC §6229(d). The FPAA suspends the running of the IRC §6229(a) period until one year after the close of the period during which a petition for readjustment of the partnership items may be filed, or, if such a petition is filed, one year after the court's decision in that proceeding becomes final. *Id.; see United States v. Martinez* (*In re Martinez*), 564 F.3d, 719, 727 (5th Cir.2009). Of course, if a partner's limitations period has already closed, IRC §6229(d) cannot re-open that period.

An individual's limitations period would also be extended *forever* if that person filed "a false or fraudulent return with the intent to evade tax." IRC §6501(c)(1).

still open that we could do an assessment."

The practical result of our holding today is that the Commissioner may issue an FPAA at *anytime,* subject only to the practical limitation that the FPAA may affect only those partners whose individual returns remain open under IRC §6501(a) or some extension thereto, such as the *minimum* period of IRC §6229(a), before which the statute of limitations may not expire. Stated differently, the Commissioner is free to assess partnership-item tax on any taxpayer who, on his individual tax return, has taken advantage of the now-challenged partnership items within the preceding three years (or, in the event of an extension, within the extended statute of limitations). Even though our holding will permit assessments against some partners and not against others, depending on their respective limitations periods under IRC §6501(a), this interpretation is consistent with the other portions of IRC §6229, which explicitly contemplate distinct treatment of different partners.[39] If Congress intended a different result, it is for Congress — not this court — to re-draft the statutory language.[40]

We continue briefly to explain that our decision today does not contradict this circuit's precedent. On at least two

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[39] *See, e.g.,* IRC §6229(b)(1)(A) (permitting partners to enter into *individual agreements* with the Commissioner to extend the three-year period of IRC §6229(a)); *id.* §6229(c)(1) (setting different limitations periods for partners when a partnership submits a false or fraudulent return, depending on each partner's involvement in the fraud); *id.* §6229(h) (providing for a suspension of the IRC §6229(a) period for a partner who enters bankruptcy proceedings).

[40] *Lamie v. U.S. Trustee,* 540 U.S. 526, 542, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004) ("If Congress enacted into law something different from what it intended, then it should amend the statute to conform to its intent.").

occasions — in *Weiner v. United States*[41] and *In re Martinez*[42] — we have referred to IRC §6229(a) as a three-year statute of limitations. Yet, those descriptions were mere dicta,[43] and they did not address the relationship of IRC §6229(a) to IRC §6501(a). They thus do not constrain today's decision. *Weiner* involved multiple partners who had commenced *partner-level refund suits*, arguing that IRC §6229(a) statutorily barred an FPAA.[44] There we had no need to consider the merits of the taxpayers' argument because we determined that IRC §7422(h) deprived us of jurisdiction.[45] IRC §7422(h) provides that "[n]o action may be brought for a refund attributable to partnership items."[46]

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41 389 F.3d 152, 154-55 (5th Cir.2004).

42 *United States v. Martinez (In re Martinez)*, 564 F.3d 719, 724, 726 (5th Cir.2009).

43 *See Centennial Ins. Co. v. Ryder Truck Rental, Inc.*, 149 F.3d 378, 385-86 (5th Cir.1998) ("That which is 'obiter dictum' is stated only 'by the way' to the holding of a case and does not constitute an essential or integral part of the legal reasoning behind a decision." (citing Charles W. Collier, *Precedent and Legal Authority*, 1988 WIS. L.REV. 771, 772)); *see also United States v. Crawley*, 837 F.2d 291, 292 (7th Cir.1988) (Posner, J.) (noting that as a practical matter, a court can determine whether a particular passage in an earlier opinion is dictum by considering factors such as whether "the passage was unnecessary to the outcome of the earlier case and therefore perhaps not as fully considered as it would have been if it were essential to the outcome," or whether "the passage was not an integral part of the earlier opinion — it can be sloughed off without damaging the analytical structure of the opinion, and so it was a redundant part of that opinion and, again, may not have been fully considered").

44 389 F.3d at 156.

45 *Id.* at 156-59.

46 IRC §7422(h).

And, because we held that the IRC §6229(a) period is a partnership item, "the district courts lack jurisdiction to decide the FPAA statute of limitations issue." [47] The jurisdictional issue was dispositive in *Weiner;* to the extent we discussed IRC §6229 as a strict statute of limitations for the issuance of an FPAA, it was mere dicta.

In *In re Martinez,* the issue was the extent to which a partnership's *conflicted* tax-matters partner could bind the other partners to an agreement into which he and the Commissioner had entered to extend the IRC §6229(a) period.[48] Under IRC §6229(b)(1)(B), such agreements usually bind all partners. [49] The *In re Martinez* taxpayer (who was not the tax-matters partner) argued that the tax-matters partner's conflict of interest nullified his actions with respect to the partnership. We acknowledged that "there may be times when a tax matters partner's actions beneficial to himself are so contrary to the interests of the partnership that they are rendered null with respect to the partners."[50] We concluded, however, that *In re Martinez* was not such a case, and that the extension granted to the

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[47] *See Weiner,* 389 F.3d at 156, 159. We did state, however, that one factor in favor of determination at the partnership level was that "[t]he timeliness of an FPAA affects the IRS's ability to make adjustments to partnership items, which in turn affects all partners alike." *Id.* at 158. This statement remains true because an extension of the IRC §6501(a) statute of limitations by IRC §6229(a) affects the IRS's ability to adjust partnership items, which affects all partners alike.

[48] *United States v. Martinez* (*In re Martinez*), 564 F.3d 719, 727 (5th Cir. 2009).

[49] *See* IRC §6229(b)(1)(B) ("The period described in subsection (a) ... may be extended ... with respect to all partners, by an agreement entered into by the Secretary and the tax matters partner ... before the expiration of such period.").

[50] *In re Martinez,* 564 F.3d at 728.

Commissioner applied to all partners.[51] As in *Weiner*, the interplay of IRC §6229(a) and IRC §6501(a) was not at issue, and our reference to IRC §6229(a) as a three-year statute of limitations was dicta. We thus have not previously had occasion to address squarely the instant issue, and our decision today is not in conflict with our precedent.[52]

III. CONCLUSION

We hold that the Tax Court correctly interpreted IRC §6229(a) and IRC §6501(a). IRC §6229(a) is not an

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[51] *Id.*

[52] Curr-Spec also interprets the Second Circuit's opinion in *Callaway* as rejecting *Rhone-Poulenc*. *Callaway v. Commissioner*, 231 F.3d 106, 110 (2d Cir.2000). As in our circuit's precedent, *Callaway*'s discussion of IRC §6229(a) occurred in dicta. *See id.* at 110 (referring to IRC §6229 as a three-year statute of limitations, which "supercedes" the individual partner's three-year period under IRC § 6501); *id.* at 112-13 (describing the effect that IRC §6229(a) would have had in the absence of an extension). The issue in *Callaway* was the conversion of partnership items into nonpartnership items. *See id.* at 116. The relationship of IRC §6229(a) to IRC §6501(a) was not at issue. In fact, *Callaway* interpreted the similar "shall not expire before ... 1 year" language of IRC §6229(f) as prescribing the time within which "the limitations period on assessments ... could not have expired *sooner*." *Id.* at 122 & n. 20 (emphasis in original). The court expressly said that, depending on the facts, such a provision might "not provide the limiting date." *Id.* Our analysis in the instant case is consistent with such an interpretation. Additionally, the Second Circuit has, in a subsequent case, cautioned that IRC "section 6229(a), by its terms, does not purport to *limit* the time available to assess tax, but only to *extend* limitations otherwise applicable." *Field v. United States*, 381 F.3d 109, 112 n. 1 (2d Cir.2004) (emphasis in original). Such language offers a clear indication that the Second Circuit does not view *Callaway* as having held the opposite. *See U.S. Titan, Inc. v. Guangzhou Zhen Hua Shipping Co.*, 241 F.3d 135, 149 (2d Cir.2001) ("[W]e will not overrule a prior decision of a panel of this Court absent a change in the law by higher authority or by way of an in banc proceeding of this Court." (internal quotation marks omitted)).

independent statute of limitations, i.e., it sets no maximum period within which the Commissioner must issue an FPAA. The three-year statute of limitations of IRC §6501(a) is the period within which the Commissioner may assess taxes on an individual partner (subject to *extension*) for partnership items. We also hold that the Tax Court does not overreach its jurisdiction in partnership-level proceedings when, for limitations purposes, it considers whether a partner's individual tax return remains open to assessment.

AFFIRMED.

Form 870-P(AD) (5-88) Date: 12-20-96	Department of the Treasury Internal Revenue Service Settlement Agreement For Partnership Adjustments	In Reply Refer To: MS 4550 122096-0740

Taxpayer(s) Name(s) and Address	Name of Partnership
Kenneth C Keener XXXXXXXXXX Drive Austin, TX XXXXX TIN: XXXX-XXX-XXXX	Agri-Venture-II TIN: 33-0053999 Tax Year Ended: 1984

Under the provisions of section 6224(c) of the Internal Revenue Code, the undersigned offers to enter into a settlement agreement with respect to the determination of partnership items of the partnership for the year shown on the attached schedule of adjustments. The undersigned, in accordance with the provisions of section 6224(b) of the code, also offers to waive the restrictions on the assessment and collection of any deficiency attributable to partnership items (with interest as required by law) provided in section 6225(a).

This offer is subject to acceptance for the commissioner of the internal revenue service. It will take effect as a waiver of restrictions on the date it is accepted. Unless and until it is accepted, it will have no force or effect.

If this offer is accepted for the commissioner, the treatment of partnership items under this agreement will not be reopened in the absence of fraud, malfeasance, or misrepresentation of fact; and no partnership items may be filed or prosecuted.

Signature of Taxpayer	Date
/s/ Kenneth C. Keener	3-21-97
Signature of Taxpayer	Date
By (Signature and Title)	Date

If this offer is executed by a tax matters partner, please include title with the signature.

Note: the execution and filing of this offer will expedite the adjustment of tax liability.

If this offer is executed with respect to a year for which a joint return of a husband and wife was filed, it must be signed by both spouses, unless one spouse, acting under a power of attorney, signs as agent for the other.

If the taxpayer is a corporation, the offer must be signed with the corporate name followed by the signature and title of the officer authorized to sign.

This offer may be executed by the taxpayer's attorney or agent provided this action is specifically authorized by a power of attorney, which, if not previously filed, must accompany this form.

The submission of this offer by you and the acceptance of the offer for the commissioner may result in an additional tax liability to you plus interest as provided by law. If the result is a decrease in tax, the amount of the decrease will be sent to you with interest as provided by law.

	DATE ACCEPTED FOR COMMISSIONER	SIGNATURE
FOR INTERNAL REVENUE USE ONLY	28 APR 1997 OFFICE	/s/ Larry Pagna [*sic.*] TITLE Associate Chief OGDEN, UTAH

SALT LAKE CITY APPEALS OFFICE FORM 870-P(AD) (5-88)

Stamped: RECEIVED ESU APR-3 1997 OGDEN SERVICE CENTER

Settlement Agreement For Partnership Adjustments

	Schedule of Adjustments		
Name of Partnership AGRI-VENTURE II Taxpayer Identification Number: 33-0053999	Tax Year(s) Ended December 31, 1984		
Detail of Adjustments to Ordinary Income			
Schedule F – Farming Loss	8,614,381		
Other Deductions	149,842		
Total Adjustments to Ordinary Income	8,764,223	0	0
Other Adjustment: T.P I. – Qualified Investment Expense			
(1) Adjustment	(15,182,640)		
(2) As Reported	24,099,428		
(3) Corrected	8,916,788	0	0
Other Adjustment. T.P.I. – Qualified Investment Income			
(1) Adjustment	0		
(2) As Reported	19,889		
(3) Corrected	19,889	0	0
Other Adjustment: Invest.Interest – Invest Income			
(1) Adjustment	0		
(2) As Reported	19,889		
(3) Corrected	19,889	0	0

Remarks:

Form 870-P(AD) (5-88) Date: 12-20-96	Department of the Treasury Internal Revenue Service Settlement Agreement For Partnership Adjustments	In Reply Refer To: MS 4550 122096-0927

Taxpayer(s) Name(s) and Address	Name of Partnership
Kenneth C Keener	Agri-Venture Fund
XXXXXXXXX Drive	
Austin, TX XXXXX	TIN: 33-0115708
TIN: XXXX-XXX-XXXX	Tax Year Ended: 1985

Under the provisions of section 6224(c) of the Internal Revenue Code, the undersigned offers to enter into a settlement agreement with respect to the determination of partnership items of the partnership for the year shown on the attached schedule of adjustments. The undersigned, in accordance with the provisions of section 6224(b) of the code, also offers to waive the restrictions on the assessment and collection of any deficiency attributable to partnership items (with interest as required by law) provided in section 6225(a).

This offer is subject to acceptance for the commissioner of the internal revenue service. It will take effect as a waiver of restrictions on the date it is accepted. Unless and until it is accepted, it will have no force or effect.

If this offer is accepted for the commissioner, the treatment of partnership items under this agreement will not be reopened in the absence of fraud, malfeasance, or misrepresentation of fact; and no partnership items may be filed or prosecuted.

Signature of Taxpayer	Date
/s/ Kenneth C. Keener	3-21-97
Signature of Taxpayer	Date
By (Signature and Title)	Date

If this offer is executed by a tax matters partner, please include title with the signature.

Note: the execution and filing of this offer will expedite the adjustment of tax liability.

If this offer is executed with respect to a year for which a joint return of a husband and wife was filed, it must be signed by both spouses, unless one spouse, acting under a power of attorney, signs as agent for the other.

If the taxpayer is a corporation, the offer must be signed with the corporate name followed by the signature and title of the officer authorized to sign.

This offer may be executed by the taxpayer's attorney or agent provided this action is specifically authorized by a power of attorney, which, if not previously filed, must accompany this form.

The submission of this offer by you and the acceptance of the offer for the commissioner may result in an additional tax liability to you plus interest as provided by law. If the result is a decrease in tax, the amount of the decrease will be sent to you with interest as provided by law.

	DATE ACCEPTED FOR COMMISSIONER	SIGNATURE
FOR INTERNAL REVENUE USE ONLY	28 APR 1997 OFFICE	/s/ Larry Pagna [*sic.*] TITLE Associate Chief

SALT LAKE CITY APPEALS OFFICE FORM 870-P(AD) (5-88)

Stamped: RECEIVED ESU APR-3 1997 OGDEN SERVICE CENTER

Settlement Agreement For Partnership Adjustments

Name of Partnership AGRI-VENTURE FUND Taxpayer Identification Number: 33-0053999	Schedule of Adjustments Tax Year(s) Ended December 31, 1985		
Detail of Adjustments to Ordinary Income			
Schedule F – Farming Expenses	11,806,681		
Other Deductions	218,477		
Rental Expenses/Depreciation	0		
Ordinary Income/Loss from Partnership	0	*	
Total Adjustments to Ordinary Income	12,025,158	0	0
Other Adjustment: T.P.I. – Qualified Investment Expense			
(1) Adjustment	(18,894,809)		
(2) As Reported	28,201,208		
(3) Corrected	9,306,399	0	0
Other Adjustment: T.P.I. – Qualified Investment Income			
(1) Adjustment	0		
(2) As Reported	33,154		
(3) Corrected	33,154	0	0
Other Adjustment: Invest.Interest – Invest.Income			
(1) Adjustment	0		
(2) As Reported	16,093		
(3) Corrected	16,093	0	0

Remarks:

* The tax treatment of the partnership items relating to Pump Station III Joint Venture, Agri-Venture Farming Joint Venture, Columbia Basin Growers, Desert Highland Vineyards, Houston Farm Associates II, Indo Date Associates and USB-85 Associates, will be resolved in separate partnership proceedings conducted in accordance with the TEFRA partnership procedures. The adjustments made in those partnership proceedings will be treated as computational adjustments and be assess, credited or refunded accordingly.

Continuation of Schedule of Adjustments

Settlement Agreement For Partnership Adjustments

	Schedule of Adjustments		
Name of Partnership AGRI-VENTURE FUND Taxpayer Identification Number: 33-0053999	Tax Year(s) Ended December 31, 1985		
Other Adjustment: Investment Credit Prop. – New/3 year			
(1) Adjustment	0		
(2) As Reported	182,279		
(3) Corrected	182,279	0	0
Other Adjustment: Invest. Credit Prop. – New/Other			
(1) Adjustment	0		
(2) As Reported	2,418,496		
(3) Corrected	2,418,496	0	0
Other Adjustment. Invest. Credit Prop. – Used/Other			
(1) Adjustment	0		
(2) As Reported	14,974		
(3) Corrected	14,974	0	0

Remarks:

Form 870-P(AD) (5-88) Date: 12-20-96	Department of the Treasury Internal Revenue Service Settlement Agreement For Partnership Adjustments	In Reply Refer To: MS 4550 122096-1618

Taxpayer(s) Name(s) and Address	Name of Partnership
William P., Jr. and Anne D. Smith	Richgrove Grape Associates
XXXXXXXXXX Blvd.	
Bartlesville, OK XXXXX	TIN: 33-0053994
TIN: XXXX / XXXX	Tax Year Ended: 1984

Under the provisions of section 6224(c) of the Internal Revenue Code, the undersigned offers to enter into a settlement agreement with respect to the determination of partnership items of the partnership for the year shown on the attached schedule of adjustments. The undersigned, in accordance with the provisions of section 6224(b) of the code, also offers to waive the restrictions on the assessment and collection of any deficiency attributable to partnership items (with interest as required by law) provided in section 6225(a).

This offer is subject to acceptance for the commissioner of the internal revenue service. It will take effect as a waiver of restrictions on the date it is accepted. Unless and until it is accepted, it will have no force or effect.

If this offer is accepted for the commissioner, the treatment of partnership items under this agreement will not be reopened in the absence of fraud, malfeasance, or misrepresentation of fact; and no partnership items may be filed or prosecuted.

Signature of Taxpayer	Date
/s/ Wm Smith	Feb. 1, 1999
Signature of Taxpayer	Date
/s/ Anne D. Smith	Feb. 1, 1999
By (Signature and Title)	Date

CONSISTENT AGREEMENT

If this offer is executed by a tax matters partner, please include

title with the signature.

Note: the execution and filing of this offer will expedite the adjustment of tax liability.

If this offer is executed with respect to a year for which a joint return of a husband and wife was filed, it must be signed by both spouses, unless one spouse, acting under a power of attorney, signs as agent for the other.

If the taxpayer is a corporation, the offer must be signed with the corporate name followed by the signature and title of the officer authorized to sign.

This offer may be executed by the taxpayer's attorney or agent provided this action is specifically authorized by a power of attorney, which, if not previously filed, must accompany this form.

The submission of this offer by you and the acceptance of the offer for the commissioner may result in an additional tax liability to you plus interest as provided by law. If the result is a decrease in tax, the amount of the decrease will be sent to you with interest as provided by law.

	DATE ACCEPTED FOR COMMISSIONER	SIGNATURE
FOR INTERNAL REVENUE USE ONLY	APR 09 1999	/s/ Jerry Gossett [*sic.*]
	OFFICE	TITLE Associate Chief, Appeals

So. Calif. Appeals FORM 870-P(AD) (5-88)

Settlement Agreement For Partnership Adjustments

	Schedule of Adjustments		
Name of Partnership RICHGROVE GRAPE ASSOCIATES Taxpayer Identification Number: 33-0053999	Tax Year(s) Ended December 31, 1984		
Detail of Adjustments to Ordinary Income			
Schedule F – Farming Expenses	1,841,599		
Other Deductions	46,757		
Total Adjustments to Ordinary Income	1,888,356	0	0
Other Adjustment. T.P.I. – Qualified Investment Expense			
(1) Adjustment	(3,048,599)		
(2) As Reported	4,839,046		
(3) Corrected	1,790,447	0	0
Other Adjustment: T.P.I. – Qualified Investment Income			
(1) Adjustment	0		
(2) As Reported	8,668		
(3) Corrected	8,668	0	0
Other Adjustment: Invest.Interest - Invest.Income			
(1) Adjustment	0		
(2) As Reported	8,668		
(3) Corrected	8,668	0	0

Remarks:

Form 870-P(AD) (5-88) Date: 12-20-96	Department of the Treasury Internal Revenue Service Settlement Agreement For Partnership Adjustments	In Reply Refer To: MS 4550 122096-1618

Taxpayer(s) Name(s) and Address	Name of Partnership
William P., Jr. and Anne D. Smith	Desert Highland Vineyards
XXXXXXXXXX Blvd.	
Bartlesville, OK XXXXX	TIN: 33-0121107
TIN: XXXX / XXXX	Tax Year Ended: 1985

Under the provisions of section 6224(c) of the Internal Revenue Code, the undersigned offers to enter into a settlement agreement with respect to the determination of partnership items of the partnership for the year shown on the attached schedule of adjustments. The undersigned, in accordance with the provisions of section 6224(b) of the code, also offers to waive the restrictions on the assessment and collection of any deficiency attributable to partnership items (with interest as required by law) provided in section 6225(a).

This offer is subject to acceptance for the commissioner of the internal revenue service. It will take effect as a waiver of restrictions on the date it is accepted. Unless and until it is accepted, it will have no force or effect.

If this offer is accepted for the commissioner, the treatment of partnership items under this agreement will not be reopened in the absence of fraud, malfeasance, or misrepresentation of fact; and no partnership items may be filed or prosecuted.

Signature of Taxpayer	Date
/s/ Wm Smith	Feb. 1, 1999
Signature of Taxpayer	Date
/s/ Anne D. Smith	Feb. 1, 1999
By (Signature and Title)	Date

CONSISTENT AGREEMENT

If this offer is executed by a tax matters partner, please include

title with the signature.

Note: the execution and filing of this offer will expedite the adjustment of tax liability.

If this offer is executed with respect to a year for which a joint return of a husband and wife was filed, it must be signed by both spouses, unless one spouse, acting under a power of attorney, signs as agent for the other.

If the taxpayer is a corporation, the offer must be signed with the corporate name followed by the signature and title of the officer authorized to sign.

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The submission of this offer by you and the acceptance of the offer for the commissioner may result in an additional tax liability to you plus interest as provided by law. If the result is a decrease in tax, the amount of the decrease will be sent to you with interest as provided by law.

	DATE ACCEPTED FOR COMMISSIONER	SIGNATURE
FOR INTERNAL REVENUE USE ONLY	APR 09 1999	/s/ Jerry Gossett [*sic.*]
	OFFICE	TITLE Associate Chief, Appeals

So. Calif. Appeals FORM 870-P(AD) (5-88)

Settlement Agreement For Partnership Adjustments

Name of Partnership RICHGROVE GRAPE ASSOCIATES Taxpayer Identification Number: 33-0053999	Schedule of Adjustments Tax Year(s) Ended December 31, 1984		
Detail of Adjustments to Ordinary Income			
Schedule F – Farm Loss	1,423,734		
Other Deductions	34,822		
Total Adjustments to Ordinary Income	1,462,556	0	0
Other Adjustment: T.P.I. – Qualified Investment Expense			
(1) Adjustment	(2,301,063)		
(2) As Reported	3,434,422		
(3) Corrected	1,133,359	0	0
Other Adjustment: T.P.I. – Qualified Investment Income			
(1) Adjustment	0		
(2) As Reported	3,745		
(3) Corrected	3,745	0	0
Other Adjustment: Invest.Interest – Invest.Income			
(1) Adjustment	0		
(2) As Reported	3,745		
(3) Corrected	3,745	0	0
Other Adjustment: Investment Credit Property – Used/Other			
(1) Adjustment	0		
(2) As Reported	125,000		
(3) Corrected	125,000	0	0

Remarks: